PLUMAS BANCORP
Form 10-K
March 07, 2019

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2018

or

Transaction report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 000-49883

PLUMAS BANCORP
(Exact name of Registrant as specified in its charter)

California	**75-2987096**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
35 S. Lindan Avenue, Quincy, CA	**95971**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(530) 283-7305**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Name of Each Exchange on which Registered:
Common Stock, no par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: **None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule12b-2 of the Exchange Act:

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of June 30, 2018, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately $130.6 million, based on the closing price reported to the Registrant on June 29, 2018 of $28.20 per share.

Shares of Common Stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of the affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of Common Stock of the registrant outstanding as of March 4, 2019 was 5,150,876.

Documents Incorporated by Reference: Portions of the definitive proxy statement for the 2019 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission pursuant to SEC Regulation 14A are incorporated by reference in Part III, Items 10-14.

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PART I

Forward-Looking Information

This Annual Report on Form 10-K includes forward-looking statements and information is subject to the "safe harbor" provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements, which involve Plumas Bancorp's plans, beliefs and goals, refer to estimates or use similar terms, involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors:

Local, regional, national and international economic conditions and the impact they may have on us and our customers, and our assessment of that impact on our estimates including, but not limited to, the allowance for loan losses.

The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board.

The ability of Plumas Bank to declare and pay dividends to the Company.

Changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions (including the implementation of the Basel III standards), the failure to maintain capital above the level required to be well-capitalized under the regulatory capital adequacy guidelines, the availability of capital from private or government sources, or the failure to raise additional capital as needed.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

The costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, increases in FDIC insurance premiums, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquires.

Changes in the interest rate environment and volatility of rate sensitive assets and liabilities.

Declines in the health of the economy, nationally or regionally, which could reduce the demand for loans, reduce the ability of borrowers to repay loans and/or reduce the value of real estate collateral securing most of the Company's loans.

Credit quality deterioration, which could cause an increase in the provision for loan and lease losses.

Devaluation of fixed income securities.

Asset/liability matching risks and liquidity risks.

Loss of key personnel.

Operational interruptions including data processing systems failure and fraud.

Our success at managing the risks involved in the foregoing items.

Plumas Bancorp undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements.

ITEM 1. BUSINESS

References herein to the "Company," "we," "us" and "our" refer to Plumas Bancorp and its consolidated subsidiary, unless the context indicates otherwise. References to the "Bank" refer to Company's wholly-owned subsidiary, Plumas Bank. References to "Management" refer to the members of the Company's management and references to the "Board of Directors" or the "Board" refer to the Company's Board of Directors.

General

The Company. Plumas Bancorp is a California corporation registered as a bank holding company under the *Bank Holding Company Act* of 1956, as amended, and is headquartered in Quincy, California. The Company was incorporated in January 2002 for the purposes of become Plumas Bank's holding company and acquired all of the outstanding shares of the Bank in June 2002. The Company's principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Plumas Statutory Trust I and Plumas Statutory Trust II, which were formed in 2002 and 2005 solely to facilitate the issuance of trust preferred securities.

The Company's principal source of income is dividends from the Bank, but the Company may explore supplemental sources of income in the future. The cash outlays of the Company, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, costs of repurchasing Company common stock and the cost of servicing debt, will generally be paid from dividends paid to the Company by the Bank.

At December 31, 2018, the Company had consolidated assets of $824.4 million, deposits of $726.6 million, other liabilities of $30.9 million and shareholders' equity of $66.9 million. The Company's other liabilities include $10.3 million in junior subordinated deferrable interest debentures and $13.1 million in repurchase agreements. These items are described in detail later in this Form 10-K.

Our operations are conducted at 35 South Lindan Avenue, Quincy, California. Our annual, quarterly and other reports, required under the Securities Exchange Act of 1934 and filed with the Securities and Exchange Commission, (the "SEC") are posted and are available at no cost on the Company's website, *www.plumasbank.com*, as soon as reasonably practicable after the Company files such documents with the SEC. These reports are also available through the SEC's website at *www.sec.gov*.

The Bank. The Bank is a California state-chartered bank that was incorporated in July 1980 and opened for business in December 1980. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to maximum insurable amounts. The Bank is not a member of the Federal Reserve System. The Bank's Administrative Office is located at 35 South Lindan Avenue, Quincy, California. At December 31, 2018 the Bank had approximately $824 million in assets, $562 million in net loans and $727 million in deposits (including deposits of $0.5 million from the Company). It is currently the largest independent bank headquartered in Plumas County.

The Bank's primary service area covers the Northeastern portion of California, with Lake Tahoe to the south and the Oregon border to the north. The Bank, through its thirteen-branch network, serves Washoe and Carson City counties in Nevada and the seven contiguous California counties of Plumas, Nevada, Sierra, Placer, Lassen, Modoc and Shasta. The branches are located in the California communities of Quincy, Portola, Greenville, Truckee, Fall River Mills, Alturas, Susanville, Chester, Tahoe City, Kings Beach and Redding; in addition, during December 2015 the Bank opened a branch in Reno, Nevada and effective October 26, 2018 purchased a branch in Carson City, Nevada. The Bank maintains seventeen automated teller machines ("ATMs") tied in with major statewide and national networks. In addition to its branch network, the Bank operates a lending office specializing in government-guaranteed lending in Auburn, California and commercial/agricultural lending offices located in Chico, California, Red Bluff, California and Klamath Falls, Oregon. The Bank's primary business is servicing the banking needs of these communities. Its marketing strategy stresses its local ownership and commitment to serve the banking needs of individuals living and working in the Bank's primary service areas.

With a predominant focus on personal service, the Bank has positioned itself as a multi-community independent bank serving the financial needs of individuals and businesses within the Bank's geographic footprint. Our principal retail lending services include consumer, automobile and home equity loans. Our principal commercial lending services include term real estate, commercial and industrial term loans. In addition, we provide government-guaranteed and agricultural loans as well as credit lines. We provide land development and construction loans on a limited basis.

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The Bank’s government-guaranteed lending center headquartered in Auburn, California provides Small Business Administration (SBA) and USDA Rural Development loans to qualified borrowers throughout Northern California, and Northern Nevada. During 2007 the Bank was granted nationwide Preferred Lender status with the U.S. Small Business Administration and we expect government-guaranteed lending to continue to be an important part of our overall lending operation. During 2018 proceeds from the sale of government-guaranteed loans totaled $41.7 million and we generated a gain on sale of $1.9 million. During 2017 proceeds from the sale of government-guaranteed loans totaled $36.6 million and we generated a gain on sale of $2.0 million.

The Agricultural Credit Centers located in Alturas, Chico, Red Bluff and Susanville, California and Klamath Falls, Oregon provide a complete line of credit services in support of the agricultural activities which are key to the continued economic development of the communities we serve. “Ag lending” clients include a full range of individual farming customers, small to medium-sized business farming organizations and corporate farming units.

As of December 31, 2018, the principal areas to which we have directed our lending activities, and the percentage of our total loan portfolio comprised by each, were as follows: (i) commercial real estate – 48.0%; (ii) consumer loans (including residential equity lines of credit and automobile loans) – 21.1%; (iii) agricultural loans (including agricultural real estate loans) – 12.2%; (iv); commercial and industrial loans – 8.8%; (v) construction and land development – 7.1%; and (vi) residential real estate – 2.8% .

In addition to the lending activities noted above, we offer a wide range of deposit products for the retail and commercial banking markets including checking, interest-bearing and premium interest-bearing checking, business sweep, public funds sweep, savings, time deposit and retirement accounts, as well as remote deposit, telephone and mobile banking, including mobile deposit, and internet banking with bill-pay options. Interest bearing deposits include high yield sweep accounts designed for our commercial customers and for public entities such as municipalities. As of December 31, 2018, the Bank had 33,058 deposit accounts with balances totaling approximately $727 million, compared to 31,582 deposit accounts with balances totaling approximately $663 million at December 31, 2017. We attract deposits through our customer-oriented product mix, competitive pricing, convenient locations, mobile and internet banking and remote deposit operations, all provided with a high level of customer service.

Most of our deposits are attracted from individuals, business-related sources and smaller municipal entities. This mix of deposit customers resulted in a relatively modest average deposit balance of approximately $22 thousand at December 31, 2018. However, it makes us less vulnerable to adverse effects from the loss of depositors who may be seeking higher yields in other markets or who may otherwise draw down balances for cash needs.

We also offer a variety of other products and services to complement the lending and deposit services previously reviewed. These include cashier’s checks, bank-by-mail, ATMs, night depository, safe deposit boxes, direct deposit, electronic funds transfers and other customary banking services.

Through our offering of a Remote Deposit product our business customers are able to make non-cash deposits remotely from their physical location. With this product, we have extended our service area and can now meet the deposit needs of customers who may not be located within a convenient distance of one of our branch offices.

The Bank has devoted a substantial amount of time and capital to the improvement of existing Bank services. We added mobile banking services during the first quarter of 2010. During 2015 we enhanced our mobile banking services and began offering mobile deposit services. During the first quarter of 2012 we replaced our ATMs with new state of the art machines that are ADA compliant and capable of accepting check and cash deposits without a deposit envelope. During 2015 we enhanced our mobile banking services and began offering mobile deposit services and in 2018 we began offering the ability for our customers to send money to others from their mobile devices through a linked debit card ("P2P" transfers).

The officers and employees of the Bank are continually engaged in marketing activities, including the evaluation and development of new products and services, to enable the Bank to retain and improve its competitive position in its service area.

We hold no patents or licenses (other than licenses required by appropriate bank regulatory agencies or local governments), franchises, or concessions. Our business has a modest seasonal component due to the heavy agricultural and tourism orientation of some of the communities we serve. We are not dependent on a single customer or group of related customers for a material portion of our deposits. The Company's management has established loan concentration guidelines as a percentage of capital and evaluates loan concentration levels within a single industry or group of related industries on quarterly basis, or more frequently as loan conditions change. There has been no material effect upon our capital expenditures, earnings, or competitive position as a result of federal, state, or local environmental regulation.

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Commitment to our Communities. The Board of Directors and Management believe that the Company plays an important role in the economic well-being of the communities it serves. Our Bank has a continuing responsibility to provide a wide range of lending and deposit services to both individuals and businesses. These services are tailored to meet the needs of the communities served by the Company and the Bank.

We offer various loan products which encourage job growth and support community economic development. Types of loans offered range from personal and commercial loans to real estate, construction, agricultural, automobile and government-guaranteed loans. Many banking decisions are made locally with the goal of maintaining customer satisfaction through the timely delivery of high quality products and services.

Recent Expansion Activities. On July 31, 2015 the Bank completed its acquisition of the Redding, California, branch of Rabobank N.A. The transaction included the acquisition of approximately $10 million in deposits. The branch, located at 1335 Hilltop Dr. in Redding, now operates as a branch of the Bank. Following the acquisition, the Bank consolidated its preexisting branch Redding branch on Civic Center Drive branch into this location. The Civic Center Drive facility was sold to an unrelated third party in December 2015.

In December 2015 the Bank opened a full-service branch located at 5050 Meadowood Mall Circle, Reno, Nevada. This was the Bank's first branch location outside of California. On October 26, 2018 we acquired a branch located in Carson City, Nevada from Mutual of Omaha Bank. This transaction resulted in the acquisition of $45.6 million in deposits and $1.8 million in loans and the recording of $1.1 million in intangible assets.

Dividends. It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends, subject to the approval of the Board of Directors. On October 20, 2016 the Company announced that its Board of Directors approved the reinstatement of a semi-annual cash dividend. The dividend in the amount of $0.10 per share was paid on November 21, 2016 to shareholders of record at the close of business day on November 7, 2016. A semi-annual cash dividend totaling $0.14 per share was paid on May 15, 2017 and November 15, 2017 and a semi-annual cash dividend totaling $0.18 per share was paid on May 15, 2018 and November 15, 2018.

Trust Preferred Securities. During the third quarter of 2002, the Company formed a wholly owned Connecticut statutory business trust, Plumas Statutory Trust I (the "Trust I"). On September 26, 2002, the Company issued to the Trust I, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2032 (the "Debentures") in the aggregate principal amount of $6,186,000. In exchange for these debentures the Trust I paid the Company $6,186,000. The Trust I funded its purchase of debentures by issuing $6,000,000 in floating rate capital securities ("trust preferred securities"), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust I. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 3.40%, not to exceed 11.9%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

During the third quarter of 2005, the Company formed a wholly owned Delaware statutory business trust, Plumas Statutory Trust II (the "Trust II"). On September 28, 2005, the Company issued to the Trust II, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2035 (the "Debentures") in the aggregate principal amount of $4,124,000. In exchange for these debentures the Trust II paid the Company $4,124,000. The Trust II funded its purchase of debentures by issuing $4,000,000 in floating rate capital securities ("trust preferred securities"), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust II. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 1.48%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

The trust preferred securities are mandatorily redeemable upon maturity of the Debentures on September 26, 2032 for Trust I and September 28, 2035 for Trust II, or upon earlier redemption as provided in the indenture.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") excludes trust preferred securities issued after May 19, 2010, from being included in Tier 1 capital, unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued prior to that date will continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, such as the Company.

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Neither Trust I nor Trust II are consolidated into the Company's consolidated financial statements and, accordingly, both entities are accounted for under the equity method and the junior subordinated debentures are reflected as debt on the consolidated balance sheet.

Business Concentrations. No individual or single group of related customer accounts is considered material in relation to the Bank's assets or deposits, or in relation to our overall business. However, at December 31, 2018 approximately 71% of the Bank's total loan portfolio consisted of real estate-secured loans, including real estate mortgage loans, real estate construction loans, consumer equity lines of credit, and agricultural loans secured by real estate. Moreover, our business activities are currently focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta and Sierra and Washoe and Carson City Counties in Nevada. Consequently, our results of operations and financial condition are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in these areas of California and Nevada exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires, drought and floods in these regions in California and Nevada.

Competition. The banking business is highly competitive. The business is largely dominated by a relatively small number of major banks with many offices operating over a wide geographical area. These banks have, among other advantages, the ability to finance wide-ranging and effective advertising campaigns and to allocate their resources to regions of highest yield and demand. Many of the major banks operating in the area offer certain services that we do not offer directly but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, such banks also have substantially higher lending limits than we do. For customers whose loan demands exceed our legal lending limit, we attempt to arrange for such loans on a participation basis with correspondent or other banks.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions such as finance companies, leasing companies, insurance companies, brokerage firms, Internet-based lending platforms and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal financial software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers. Mergers between financial institutions have placed additional competitive pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues. Competition has also intensified due to federal and state interstate banking laws enacted in the mid-1990's, which permit banking organizations to expand into other states. The relatively large California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which became effective March 11, 2000, has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, and has also intensified competitive conditions.

Currently, within towns in which the Bank has a branch, excluding Carson City, there are 106 banking branch offices of competing institutions (excluding credit unions, but including savings banks), including 69 branches of 11 banks having assets more than $10 billion. As of June 30, 2018, the FDIC estimated the Bank's market share of insured deposits within the communities it serves to be as follows: Greenville and Portola 100%, Quincy 86%, Chester 66%, Alturas 59%, Fall River Mills 36%, Kings Beach 32%, Susanville 43%, Truckee 14%, Tahoe City 22%, Redding 1% and Reno less than 1%.

Technological innovations have also resulted in increased competition in financial services markets. Such innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously were considered traditional banking products. In addition, many customers now expect a choice of delivery systems and channels, including home computer, mobile, remote deposit, telephone, ATMs, mail, full-service branches and/or in-store branches. The sources of competition in such products include traditional banks as well as savings associations, credit unions, brokerage firms, money market and other mutual funds, asset management groups, finance and insurance companies, internet-only financial intermediaries, and mortgage banking firms.

For many years we have countered rising competition by providing our own style of community-oriented, personalized service. We rely on local promotional activity, personal contacts by our officers, directors, employees, and shareholders, automated 24-hour banking, and the individualized service that we can provide through our flexible policies. This approach appears to be well-received by our customers who appreciate a more personal and customer-oriented environment in which to conduct their financial transactions. To meet the needs of customers who prefer to bank electronically, we offer telephone banking, mobile banking, remote deposit, mobile deposit and internet banking with bill payment capabilities. This high tech and high touch approach allows the customers to tailor their access to our services based on their particular preference.

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Employees. At December 31, 2018, the Company and its subsidiary employed 174 persons. On a full-time equivalent basis, we employed 155 persons. None of the Company's employees are represented by a labor union, and management considers its relations with employees to be good.

Code of Ethics. The Board of Directors has adopted a code of business conduct and ethics for directors, officers (including the Company's principal executive officer and principal financial officer) and financial personnel, known as the Corporate Governance Code of Ethics. This Code of Ethics is available on the Company's website at www.plumasbank.com. Shareholders may request a free copy of the Code of Ethics Policy from Plumas Bancorp, Ms. Elizabeth Kuipers, Investor Relations, 35 S. Lindan Avenue, Quincy, California 95971.

Supervision and Regulation

General. As banking institution, we are extensively regulated under federal and state law. These laws and regulations are generally intended to protect depositors and customers, not our shareholders. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statute or regulation. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. Any change in applicable laws or regulations may have a material effect on our business and prospects. We cannot accurately predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, or new federal or state legislation may have in the future.

Holding Company Regulation. We are a registered bank holding company under the Bank Holding Company Act of 1956, as amended, and are subject to the supervision of, and regulation by, the Board of Governors of the Federal Reserve System (the "FRB"). We are required to file reports with the FRB and the FRB periodically examines the Company. A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank. FRB regulations require the Company to meet or exceed certain capital requirements and regulate provisions of certain bank holding company debt. The Company is also a bank holding company within the meaning of Section 3700 of the California Financial Code. Therefore, the Company and any of its subsidiaries are subject to supervision and examination by, and may be required to file reports with, the California Department of Business Oversight ("DBO").

The activities of bank holding companies are generally limited to the business of banking, managing or controlling banks, and other activities that the FRB has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies that qualify and register as "financial holding companies" are also able to engage in certain additional financial activities, such as merchant banking and securities and insurance underwriting, subject to limitations set forth in federal law. The Company has not elected to become a financial holding company. As a bank holding company, the Company must to obtain prior approval of the FRB before taking any action that causes a bank to become a controlled subsidiary of the bank holding company; acquiring direct or indirect ownership 5% of the outstanding shares of any class of voting securities another bank or bank holding company, acquiring all or substantially all the assets of a bank or merging or consolidating with another bank holding company.

Federal and State Bank Regulation. As a California-chartered commercial bank with deposits insured by the FDIC, the Bank is subject to the supervision and regulation of the DBO and the FDIC, as well as certain of the regulations of the FRB and the Consumer Financial Protection Bureau ("CFPB"). The DBO and the FDIC regularly examine the Bank and may prohibit the Bank from engaging in what they believe constitute unsafe or unsound banking practices or violations of law.

Securities Regulation. The Company is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the Securities and Exchange Commission. As a listed company on NASDAQ, we are subject to NASDAQ rules for listed companies.

Capital Adequacy. The FDIC has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

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A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies.

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks, sometimes called "Basel III". The phase-in period for the final rules began in 2015, with certain of the rules' requirements phased in over a multi-year schedule. Under the final rules minimum requirements increased for both the quantity and quality of capital held by the Company and the Bank. The new capital rules include a new minimum "common equity Tier 1" ratio of 4.5%, a Tier 1 capital ratio of 6.0% (increased from 4.0%), a total risk-based capital ratio of 8.0%, and a minimum leverage ratio of 4.0% (calculated as Tier 1 capital to average consolidated assets). The effective date of these requirements was January 1, 2015. In addition, the new capital rules include a capital conservation buffer of 2.5% above each of these levels (to be phased in over three years which beginning at 0.625% on January 1, 2016 and increasing by that amount on each subsequent January 1, until reaching 2.5% on January 1, 2019) will be required for banking institutions to avoid restrictions on their ability to pay dividends, repurchase stock or pay discretionary bonuses. When fully phased in and including the capital conservation buffer of 2.5%, the new capital rules would result in the following minimum ratios for the Bank to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7.0%, and (iii) a total capital ratio of 10.5%. The new capital rules also implement strict eligibility criteria for regulatory capital instruments.

Under the new capital rules, the minimum capital ratios as of January 1, 2018 through December 31, 2018 (including the capital conservation buffer as then phased in) were as follows: a common equity Tier 1 capital ratio of 6.375%; a Tier 1 capital ratio of 7.875%; a total capital risk-based capital ratio of 9.875% and a minimum leverage ratio of 4.0%.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC and/or the DBO to ensure the maintenance of required capital levels. Federal law requires, among other things, that federal bank regulators take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. For this purpose, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, restrictions on interest rates paid on deposits, restrictions or prohibitions on payment of dividends, and restrictions on the acceptance of brokered deposits. Furthermore, if an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency, and the holding company and any other company deemed to control the bank must guarantee the performance of that plan. Under current regulations, a depository institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. At December 31, 2018, the Bank's capital ratios exceed the thresholds necessary to be considered “well capitalized.”

Under the FRB’s Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the “Policy Statement”), certain bank holding companies with less than $1 billion in consolidated assets are exempt from the consolidated capital rules. The Company qualifies for treatment under the Policy Statement and is not currently subject to consolidated capital rules at the bank holding company level. On May 24, 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Relief Act”) was signed into law. The Relief Act included a provision to increase the threshold for qualifying for the Policy Statement from $1 billion to $3 billion in total assets.

The new capital rules continue to apply to the Bank. Consistent with the Relief Act, however, the federal banking agencies have proposed a new community bank leverage ratio that is intended to simply the regulatory capital requirements for qualifying community banking organizations. Under the proposal, a qualifying banking organization that so elects would be deemed to have met the well-capital capitalized ratio requirements under the prompt corrective action framework and would be exempt from the generally applicable new capital rules if it maintains a new “community bank leverage ratio” in excess of 9%. The proposed community bank leverage ratio would be equal to tangible equity (as defined the proposal) divided by average total consolidated assets. To qualify, a banking organization would have to have less than $10 billion in assets and limited off balance sheet exposures and other assets. We cannot predict whether or when this proposal will be adopted.

For additional information, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Standards.”

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Dividends. The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. The California General Corporation Law permits a California corporation such as the Company to make a distribution to its shareholders if its retained earnings equal at least the amount of the proposed distribution or if after giving effect to the distribution, the value of the corporation's assets exceed the amount of its liabilities plus the amount of shareholders preferences, if any, and certain other conditions are met.

It is the Federal Reserve's policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings support the organization's expected future needs and financial condition. Further, it is the FRB's policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to its banking subsidiaries. The Federal Reserve also discourages dividend payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

In addition, the Company's ability to pay dividends is subject to certain covenants contained in the indentures relating to the trust preferred securities issued by the Company's business trust subsidiaries.

The Bank is a legal entity that is separate and distinct from its holding company. The Company is dependent on the performance of the Bank for funds which may be received as dividends from the Bank for use in the operation of the Company and the ability of the Company to pay dividends to shareholders. Future cash dividends by the Bank will also depend upon management's assessment of future capital requirements, contractual restrictions, and other factors.

The California Financial Code restricts the dividends that the Bank may pay to the Company to the lesser of the Bank's retained earnings or the Bank's net income for the latest three fiscal years, less dividends previously declared during that period, or, with the approval of the DBO, to the greater of the retained earnings of the Bank, the net income of the Bank for its last fiscal year, or the net income of the Bank for its current fiscal year. As of December 31, 2018, the maximum amount available for dividend distribution under this restriction was approximately $21.4 million. In addition, the Bank is subject to the new capital rules and the capital conservation buffer discussed above.

Loans-to-One Borrower. Under California law, the Bank's ability to make aggregate secured and unsecured loans-to-one-borrower is limited to 25% and 15%, respectively, of unimpaired capital and surplus. At December 31, 2018, the Bank's limit on aggregate secured loans-to-one-borrower was $20.8 million and unsecured loans-to-one borrower was $12.5 million. The Bank has established internal loan limits that are lower than the legal lending limits for a California bank.

The Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires that, in connection with examinations of financial institutions within its jurisdiction, the federal banking regulators evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or new facility. A less than "Satisfactory" rating would likely result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of the most recent report of examination the Bank's CRA rating was "Satisfactory."

Transactions with Affiliates. Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders (including the Company) or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

The Federal Reserve Act and the FRB's Regulation W limit the amount of certain loan and investment transactions between the Bank and its affiliates, require certain levels of collateral for such loans, and limit the amount of advances to third parties that may be collateralized by the securities of the Company or its subsidiaries. Regulation W requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies. The Company and its subsidiaries have adopted an Affiliate Transactions Policy and have entered into various affiliate agreements in compliance with Regulation W.

Safety and Soundness Standards. The FRB and the FDIC have adopted non-capital safety and soundness standards for institutions. These standards cover internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that it will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

Federal Deposit Insurance. In addition to supervising and regulating state-chartered non-member banks, the FDIC insures the Bank's deposits, up to prescribed statutory limits, through the Deposit Insurance Fund (the "DIF"), currently $250,000 per depositor per institution. The DIF is funded primarily by FDIC assessments paid by each DIF member institution. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. The Bank's FDIC insurance expense totaled $216 thousand for 2018.

Additionally, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the DIF. The Bank's FICO assessments totaled $21 thousand for 2018. These assessments will continue until the FICO bonds mature in 2019.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank's depositors. Under California law, the termination of the Bank's deposit insurance would result in a termination of the Bank's charter.

Interstate Branching. The Dodd-Frank Act authorized national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks may now enter new markets more freely.

Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, including but not limited to the following:

The Equal Credit Opportunity Act generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act ("TILA") is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things. As a result of the Dodd-Frank Act, Regulation Z promulgated under the TILA includes new limits on loan originator compensation for all closed-end mortgages. These changes include, prohibiting certain payments to a mortgage broker or loan officer based on the transaction's terms or conditions, prohibiting dual compensation, and prohibiting a mortgage broker or loan officer from ‘‘steering’’ consumers to transactions not in their interest, to increase mortgage broker or loan officer compensation.

The Fair Housing Act ("FH Act") regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

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The Home Mortgage Disclosure Act (“HMDA”), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a “fair lending” aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Right to Financial Privacy Act imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

The Real Estate Settlement Procedures Act (“RESPA”) requires lenders to provide noncommercial borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory expectations related to compliance generally, the Company may incur additional compliance costs.

The Dodd-Frank Act created the CFPB as a new, independent federal agency. The CFPB has broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions, including the Bank, are generally subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes.

Anti-Money Laundering Laws. A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the US PATRIOT Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities.

Privacy and Data Security. The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposes requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators, including the FDIC, to prescribe standards for the security of consumer information. The Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach. The Bank is required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal of information that is no longer needed. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Potential Enforcement Actions; Supervisory Agreements. Under federal law, the Company, the Bank and their institution-affiliated parties may be the subject of potential enforcement actions by the FRB (in the case of the Company) or the FDIC (in the case of the Bank) for unsafe and unsound practices in conducting their businesses, or for violations of any law, rule or regulation or provision, any consent order with any agency, any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance of deposits, the imposition of civil money penalties, the payment of restitution and removal and prohibition orders against institution-affiliated parties. The DBO also has authority to bring similar enforcement actions against the Bank.

Legislation and Proposed Changes. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. Typically, the intent of this type of legislation is to strengthen the banking industry, even if it may on occasion prove to be a burden on management’s plans. No prediction can be made as to the likelihood of any major changes or the impact that new laws or regulations might have on us.

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Effects of Government Monetary Policy. Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the FRB. The FRB implements national monetary policy for such purposes as curbing inflation and combating recession, through its open market operations in U.S. Government securities, control of the discount rate applicable to borrowings from the FRB, and establishment of reserve requirements against certain deposits. These activities influence growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The Company's profitability, like most financial institutions, is primarily dependent on interest rate spreads. In general, the difference between the interest rates paid by the Bank on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by the Bank on interest-earning assets, such as loans extended to customers and securities held in the investment portfolio, will comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors that are beyond our control, such as inflation, recession and unemployment, the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the FRB and the impact which future changes in domestic and foreign economic conditions might have on us cannot be predicted. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

Recent Accounting Pronouncements

See Note 2 – "Summary of Significant Accounting Policies – Adoption of New Accounting Standards" of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K for information related to recent accounting pronouncements.

ITEM 1A. RISK FACTORS

A deterioration of national or local economic conditions could reduce the Company's profitability.

The Company's lending operations and its customers are primarily located in the eastern region of Northern California. A significant downturn in the national economy or the local economy due to agricultural commodity prices, real estate prices, public policy decisions, natural disaster, drought or other factors could result in a decline in the local economy in general, which could in turn negatively impact the Company's business, financial condition, results of operations and prospects.

The majority of the Company's assets are loans, which if not repaid would result in losses to the Bank.

The Bank, like other lenders, is subject to credit risk, which is the risk of losing principal or interest due to borrowers' failure to repay loans in accordance with their terms. Underwriting and documentation controls cannot mitigate all credit risk. Accordingly, the Company's results of operations will be directly affected by the volume and timing of loan losses, which for a number of reasons can vary from period to period. The risks of loan losses may be exacerbated by a downturn in the economy or the real estate market in the Company's market areas or a rapid increase in interest rates, which could have a negative effect on collateral values and borrowers' ability to repay. To the extent loans are not paid timely by borrowers, the loans are placed on non-accrual status, thereby reducing interest income. Further, under these circumstances, an additional provision for loan and lease losses or unfunded commitments may be required, which could negatively impact the Company's income and capital. See Management's Discussion and Analysis of Financial Condition and Results of Operations – "Analysis of Asset Quality and Allowance for Loan Losses".

If the Company's allowance for loan losses is not sufficient to absorb actual loan losses, the Company's profitability could be reduced.

The risk of loan losses is inherent in the lending business. The Company maintains an allowance for loan losses based upon the Company's actual losses over a relevant time period and management's assessment of all relevant qualitative factors that may cause future loss experience to differ from its historical loss experience. Although the Company maintains a rigorous process for determining the allowance for loan losses, it can give no assurance that it will be sufficient to cover future loan losses. If the allowance for loan losses is not adequate to absorb future losses, or if bank regulatory agencies require the Company to increase its allowance for loan losses, earnings could be significantly and adversely impacted.

A deterioration in the real estate market could have a material adverse effect on the Company's business, financial condition and results of operations.

As of December 31, 2018, approximately 71% of the Company's total loan portfolio is secured by real estate, the majority of which is commercial real estate. Increases in commercial and consumer delinquency levels or declines in real estate market values would require increased net charge-offs and increases in the allowance for loan losses, which could have a material adverse effect on the Company's business, financial condition and results of operations and prospects.

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The FASB has recently issued an accounting standard update that will result in a significant change in how we recognize credit losses and may have a material impact on our results of operations, financial condition or liquidity.

In June 2016, the Financial Accounting Standards Board issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires banking organizations to determine the adequacy of their allowance for loan losses with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. Under the CECL model, banking organizations will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current GAAP, which delays recognition until it is probable a loss has been incurred. ASU 2016-13 is expected to be effective for public business entities for fiscal years after December 15, 2019. CECL will change the manner in which the Company determines the adequacy of its allowance for loan losses. The Company is evaluating the impact the CECL model will have on its accounting, but the Company may recognize a one-time cumulative-effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. The Company cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on its financial condition or results of operations. The federal banking regulators have adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital.

Fluctuations in interest rates could reduce profitability.

The Company's earnings depend largely upon net interest income, which is the difference between the total interest income earned on interest earning assets (primarily loans and investment securities) and the total interest expense incurred on interest bearing liabilities (primarily deposits and borrowed funds). The interest earned on assets and paid on liabilities are affected principally by direct competition, and general economic conditions at the state and national level and other factors beyond the Company's control such as actions of the FRB, the general supply of money in the economy, legislative tax policies, governmental budgetary matters, and other state and federal economic policies. Although the Company maintains a rigorous process for managing the impact of possible interest rate fluctuations on earnings, the Company can provide no assurance that its management efforts will prevent earnings from being significantly and adversely impacted by changes in interest rates.

The Company could be required to raise additional capital in the future, but that capital may not be available when it is needed or may not be available on terms that are favorable to the Company.

Federal and state bank regulatory authorities require the Company and the Bank to maintain adequate levels of capital to support their operations. The Company’s ability to raise additional capital if and as needed depends on conditions in the capital markets, which are outside the Company’s control, and on the Company’s financial performance. Accordingly, the Company may not be able to raise additional capital, if needed, on terms that are acceptable to the Company. If the Company is unable to raise additional capital when needed, it could be required to curtail its growth strategy or reduce the levels of assets owned. In addition, although the Company and the Bank are currently well-capitalized under applicable regulatory frameworks, bank regulators are authorized and sometimes required to impose a wide range of requirements, conditions, and restrictions on banks and bank holding companies that fail to maintain adequate capital levels.

Drought conditions in California could have an adverse impact on the Company’s business.

In recent years, California has experienced a severe drought. However, during 2016 and the first quarter of 2017 much of California has experienced significant rain. A significant portion of the Company’s borrowers are involved in or are dependent on the agricultural industry in California, which requires water. As of December 31, 2018, approximately 12% of the Company’s loans were categorized as agricultural loans. As a result of the drought, there have been governmental proposals concerning the distribution or rationing of water. If the amount of water available to agriculture becomes scarcer due to drought or rationing, growers may not be able to continue to produce agricultural products profitably, which could force some out of business. Although many of the Company’s customers are not directly involved in agriculture, they could be impacted by difficulties in the agricultural industry because many jobs and businesses in the Company’s market areas are related to the production of agricultural products. Therefore, the drought could adversely impact the Company’s loan portfolio, business, financial condition and results of operations.

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The Company faces substantial competition from larger banks and other financial institutions.

The Company faces substantial competition for deposits and loans. Competition for deposits primarily comes from other commercial banks, savings institutions, thrift and loan associations, money market and mutual funds and other investment alternatives. Competition for loans comes from other commercial banks, savings institutions, credit unions, mortgage banking firms, thrift and loan associations and other financial intermediaries. Larger competitors, by virtue of their larger capital resources, have substantially greater lending limits and marketing resources than the Company. In addition, they have greater resources and may be able to offer longer maturities or lower rates. The Company's competitors may also provide certain services for their customers, including trust and international banking that the Company is only able to offer indirectly through correspondent relationships. Ultimately, competition can reduce the Company's profitability, as well as make it more difficult to increase the size of its loan portfolio and deposit base.

There are risks associated with the Company's growth strategy.

During the past three years, the Company has completed the purchase and assumption of a branch office in Redding, California, completed the purchase and assumption of a branch office in Carson City, Nevada, opened a branch office in Reno, Nevada and established loan production offices in Red Bluff, California and Klamath Falls, Oregon. The Company may engage in additional acquisition activity and open additional offices in the future to expand the Company's markets or further its growth strategy. Acquiring other banks or branches involves various other risks commonly associated with acquisitions, including, difficulty in estimating the value of the business to be acquired, integrating the operations and retaining key employees and customers. There is no assurance that future acquisitions or offices will be successful. Further, growth may strain the Company's administrative, managerial, financial and operational resources and increase demands on its systems and controls. If the Company pursues its growth strategy too aggressively, fails to attract qualified personnel, control costs or maintain asset quality, or if factors beyond management's control divert attention away from its business operations, the Company's pursuit of its growth strategy could have a material adverse impact on its existing business .

The Company relies on key executives and personnel and the loss of any of them could have a material adverse impact on the Company's prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out the Company's strategies is often lengthy. The Company's success depends to a significant degree upon its ability to attract and retain qualified management, loan origination, finance, administrative, marketing, compliance and technical personnel and upon the continued contributions of its management and personnel. In particular, the Company's success has been and continues to be highly dependent upon the abilities of key executives and certain other employees.

Security breaches and technological disruptions could damage the Company's reputation and profitability. The Company's business is highly reliant on third party vendors and its ability to manage the operational risks associated with outsourcing those services.

The Company's electronic banking activities expose it to possible liability and harm to its reputation should an unauthorized party gain access to confidential customer information. Despite its considerable efforts and investment to provide the security and authentication necessary to effect secure transmission of data, the Company cannot fully guarantee that these precautions will protect its systems from future compromises or breaches of its security measures. Although the Company has developed systems and processes that are designed to recognize and assist in preventing security breaches (and periodically test its security), failure to protect against or mitigate breaches of security could adversely affect its ability to offer and grow its online services, constitute a breach of privacy or other laws, result in costly litigation and loss of customer relationships, negatively impact the Bank's reputation, and could have an adverse effect on its business, results of operations and financial condition. The Company may also incur substantial increases in costs in an effort to minimize or mitigate cyber security risks and to respond to cyber incidents.

The potential for operational risk exposure exists throughout the Company's business. Integral to the Company's performance is the continued efficacy of the Company's technology and information systems, operational infrastructure and relationships with third parties and its colleagues in its day-to-day and ongoing operations. Failure by any or all of these resources subjects us to risks that may vary in size, scale and scope. This includes, but is not limited to, operational or systems failures, disruption of client operations and activities, ineffectiveness or exposure due to interruption in third party support as expected, as well as, the loss of key colleagues or failure on the part of key colleagues to perform properly.

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Additionally, the Company outsources a large portion of its data processing to third parties which may encounter technological or other difficulties that may significantly affect the Company's ability to process and account for customer transactions. These vendors provide services that support its operations, including the storage and processing of sensitive consumer and business customer data, as well as its sales efforts. A cyber security breach of a vendor's system may result in theft of the Company's data or disruption of business processes. In most cases, the Company will remain primarily liable to its customers for losses arising from a breach of a vendor's data security system. The Company relies on its outsourced service providers to implement and maintain prudent cyber security controls. The loss of these vendor relationships could disrupt the services the Company provides to its customers and cause us to incur significant expense in connection with replacing these services.

The Company may face regulatory enforcement actions, incur fines, penalties and other negative consequences from regulatory violations, possibly even inadvertent or unintentional violations.

The Company is subject to significant federal and state regulation and supervision. In the past, the Company's business has been increasingly affected by these regulations, and this trend is likely to continue into the future. Many of these laws are subject to interpretation and changing regulatory approaches to supervision and enforcement. The Company maintains systems and procedures designed to ensure that it complies with applicable laws and regulations, but there can be no assurance that these will be effective. The Company may face regulatory enforcement actions and incur fines, penalties and other negative consequences from regulatory violations. The Company may also suffer other negative consequences resulting from findings of noncompliance with laws and regulations, that may also damage its reputation, and this in turn might materially affect its business and results of operations. Further, some legal/regulatory frameworks provide for the imposition of fines, restitution or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there were in place at the time systems and procedures designed to ensure compliance.

The Company's disclosure controls and procedures may not prevent or detect all errors or acts of fraud.

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in reports it files under the Exchange Act is accurately accumulated and communicated to management, and recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. The Company believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, cannot provide absolute assurance that the objectives of the control system are met.

These inherent limitations include the realities that judgments in decision making can be faulty, that alternative reasoned judgments can be drawn, or that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in its control system, misstatements due to error or fraud may occur and not be detected, which could result in a material weakness in its internal controls over financial reporting and the restatement of previously filed financial statements.

The price of the Company's common stock may be volatile or may decline.

The trading price of the Company's common stock may fluctuate as a result of a number of factors, many of which are outside its control. Among the factors that could affect the Company's stock price are:

- actual or anticipated quarterly fluctuations in the Company's operating results and financial condition;
- research reports and recommendations by financial analysts;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community;
- actions by the Company or its competitors, such as acquisitions or restructurings;
- actions by institutional shareholders;
- fluctuations in the stock prices and operating results of its competitors;

- general market conditions and, in particular, developments related to market conditions for the financial services industry;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings or litigation that involve or affect us;
- domestic and international economic factors unrelated to its performance.

Significant decline in the Company’s stock price could result in substantial losses for individual shareholders and could lead to costly and disruptive securities litigation.

The trading volume of the Company’s common stock is limited.

Although the Company’s common stock is traded on the Nasdaq Stock Market, trading volume to date has been relatively modest. The limited trading market for the Company’s common stock may lead to exaggerated fluctuations in market prices and possible market inefficiencies compared to more actively traded securities. It may also make it more difficult for investors to sell the Company’s common stock at desired prices, especially for holders seeking to dispose of a large number of shares of stock.

The Company depends primarily on the operations of the Bank to pay dividends, repurchase shares, repay its indebtedness and fund its operations. The Bank’s ability to pay dividends to the Company depends on the success of the Bank’s operations.

The Company is a separate and distinct legal entity from its subsidiary, the Bank, and it receives substantially all of its revenue from dividends paid by the Bank. There are legal limitations on the extent to which the Bank may extend credit, pay dividends or otherwise supply funds to, or engage in transactions with, the Company. The Company’s inability to receive dividends from the Bank could adversely affect its business, financial condition, results of operations and prospects. Even if applicable laws and regulations would permit the Bank to pay dividends to Company and would permit the Company to pay dividends to its shareholders, the Board of Directors could determine that it is not in the best interest of the Company’s shareholders to do so in order to preserve or redeploy our capital resources, for example. For these reasons, the amount and frequency of dividends that the Company pays to shareholders may vary from time to time.

Reduction in the value, or impairment of our investment securities, can impact our earnings and common shareholders' equity.

Generally Accepted Accounting Principles ("GAAP") require the Company to carry its available-for-sale investment securities at fair value on its balance sheet. Unrealized gains or losses on these securities, reflecting the difference between the fair market value and the amortized cost, net of its tax effect, are reported as a component of shareholders' equity. In certain instances, GAAP requires recognition through earnings of declines in the fair value of securities that are deemed to be other than temporarily impaired. Changes in the fair value of these securities may result from a number of circumstances that are beyond the Company's control, such as changes in interest rates, the financial condition of government sponsored enterprises or insurers of municipal bonds, changes in demand for these securities as a result of economic conditions, or reduced market liquidity. There can be no assurance that the declines in market value will not result in other than temporary impairments of these assets, which would lead to loss recognition that could have a material adverse effect on the Company's net income and capital levels.

Damage to the Company's reputation could significantly harm the Company's business and prospects.

The Company's reputation is an important asset. The Company's relationship with many of its customers is predicated upon its reputation as a high-quality provider of financial services that adheres to the highest standards of ethics, service quality and regulatory compliance. The Company's ability to attract and retain customers, investors and employees depends upon external perceptions. Damage to its reputation among existing and potential customers, investors and employees could cause significant harm to the Company's business and prospects and may arise from numerous sources, including litigation or regulatory actions, failing to deliver minimum standards of service and quality, lending practices, inadequate protection of customer information, sales and marketing efforts, compliance failures, unethical behavior and the misconduct of employees. Adverse developments in the banking industry may also, by association, negatively impact the Company's reputation or result in greater regulatory or legislative scrutiny or litigation against us. The Company has policies and procedures in place that seek to protect its reputation and promote ethical conduct, but these policies and procedures may not be fully effective. Negative publicity regarding the Company's business, employees, or customers, with or without merit, may result in the loss of customers, investors, and employees, costly litigation, a decline in revenues and increased governmental regulation.

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The markets in which the Company operates are subject to the risk of earthquakes and other natural disasters.

Most of the Company’s offices are located in California. Also, most of the real and personal properties securing the Company’s loans are located in California. California is prone to earthquakes, brush fires, flooding and other natural disasters. In addition to possibly sustaining damage to its own properties, if there is a major earthquake, brush fires, flood or other natural disaster, the Company faces the risk that many of the Company’s borrowers may experience uninsured property losses, or sustained job interruption and/or loss which may materially impair their ability to meet the terms of their loan obligations. Therefore, a major earthquake, brush fire, flood or other natural disaster in California could have a material adverse effect on the Company’s business, financial condition, results of operations and cash flows.

The Company is exposed to risk of environmental liabilities with respect to real properties that is may acquire.

If the Company’s borrowers are unable to meet their loan repayment obligations, it will initiate foreclosure proceedings with respect to and may take actions to acquire title to the personal and real property that collateralized their loans. As an owner of such properties, the Company could become subject to environmental liabilities and incur substantial costs for any property damage, personal injury, investigation and clean-up that may be required due to any environmental contamination that may be found to exist at any of those properties, even though it did not engage in the activities that led to such contamination. In addition, if the Company were the owner or former owner of a contaminated site, it could be subject to common law claims by third parties seeking damages for environmental contamination emanating from the site. If the Company were to become subject to significant environmental liabilities or costs, its business, financial condition, results of operations and prospects could be adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

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ITEM 2. PROPERTIES

Of the Company’s thirteen depository branches, ten are owned and three are leased. The Company also leases three lending offices and owns four administrative facilities.

Owned Properties

35 South Lindan Avenue Quincy, California (1)	32 Central Avenue Quincy, California (1)	80 W. Main St. Quincy, California (1)
424 N. Mill Creek Quincy, California (1)	336 West Main Street Quincy, California	120 North Pine Street Portola, California
43163 Highway 299E Fall River Mills, California	121 Crescent Street Greenville, California	255 Main Street Chester, California
510 North Main Street Alturas, California	3000 Riverside Drive Susanville, California	8475 North Lake Boulevard Kings Beach, California
11638 Donner Pass Road Truckee, California	5050 Meadowood Mall Circle Reno, Nevada	215 N. Lake Boulevard Tahoe City, California (4)

Leased Properties

243 North Lake Boulevard Tahoe City, California	1335 Hilltop Drive Redding, California	470 Nevada St., Suite 108 Auburn, California (2)
100 Amber Grove Dr., Suite 105 Chico, CA (3)	107 S. 7th St. Klamath Falls, OR (3)	2130 Main St., Ste. B Red Bluff, California (3)
1101 N. Carson St. Carson City, Nevada		

(1) Non-branch administrative or credit administrative offices.

(2) SBA lending office.

(3) Commercial lending office.

(4) Future home of the Bank’s Tahoe City branch.

Total rental expenses under all leases totaled $340,000, $308,000 and $276,000, in 2018, 2017 and 2016 respectively. The expiration dates of the leases vary, with the first such lease expiring during 2019 and the last such lease expiring during 2022.

Future minimum lease payments for operating leases having initial or remining noncancelable lease terms in excess of one year are as follows:

Year Ending December 31,	
2019	$248,000
2020	163,000
2021	63,000
2022	59,000
2023	-
	$533,000

The Company maintains insurance coverage on its premises, leaseholds and equipment, including business interruption and record reconstruction coverage. The branch properties and non-branch offices are adequate, suitable, in good condition and have adequate parking facilities for customers and employees. The Company and Bank are limited in their investments in real property under Federal and state banking laws. Generally, investments in real property are either for the Company and Bank use or are in real property and real property interests in the ordinary course of the Bank’s business.

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ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company and/or its subsidiary are a party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company taken as a whole.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCK- HOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The Company's common stock is quoted on the NASDAQ Capital Market under the ticker symbol "PLBC". As of December 31, 2018, there were 5,137,476 shares of the Company's common stock outstanding held by approximately 1,460 shareholders of record as of the same date. The following table shows the high and low sales prices for the common stock, for each quarter as reported by Yahoo Finance.

Quarter	Common Dividends per share	High	Low
4th Quarter 2018	$ 0.18	$27.90	$20.51
3rd Quarter 2018	-	$28.50	$24.11
2nd Quarter 2018	0.18	$29.45	$23.50
1st Quarter 2018	-	$25.75	$22.70
4th Quarter 2017	$ 0.14	$23.35	$20.35
3rd Quarter 2017	-	$21.75	$19.10
2nd Quarter 2017	0.14	$22.00	$17.50
1st Quarter 2017	-	$19.50	$15.85

It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends. Such dividends help promote shareholder value and capital adequacy by enhancing the marketability of the Company's stock. All authority to provide a return to the shareholders in the form of a cash or stock dividend or split rests with the Board of Directors. The Board will periodically, but on no regular schedule and in accordance with regulatory restrictions, if any, reviews the appropriateness of a cash dividend payment. A semi-annual cash dividend totaling $0.14 per share was paid on May 15, 2017 and November 15, 2017 and a semi-annual cash dividend totaling $0.18 per share was paid on May 15, 2018 and November 15, 2018.

The Company is subject to various restrictions on the payment of dividends. See Note 12 "Shareholders' Equity – Dividend Restrictions" of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K.

Securities Authorized for Issuance under Equity Compensation Plans. The following table sets forth securities authorized for issuance under equity compensation plans as of December 31, 2018.

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	202,693	$ 13.51	236,100
Equity compensation plans not approved by security holders	None	Not Applicable	None
Total	202,693	$ 13.51	236,100

For additional information related to the above plans see Note 12 of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K.

Issuer Purchases of Equity Securities. There were no purchases of Plumas Bancorp common stock by the Company during 2018 or 2017.

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ITEM 6. SELECTED FINANCIAL DATA

The following table presents a summary of selected financial data and should be read in conjunction with the Company's consolidated financial statements and notes thereto included under Item 8 – Financial Statements and Supplementary Data.

	At or for the year ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
	(dollars in thousands except per share information)				
Statement of Income					
Interest income	$34,322	$28,953	$25,100	$22,615	$21,147
Interest expense	1,236	1,017	1,023	1,204	1,693
Net interest income	33,086	27,936	24,077	21,411	19,454
Provision for loan losses	1,000	600	800	1,100	1,100
Noninterest income	8,881	8,280	7,652	7,715	7,315
Noninterest expense	21,841	20,111	18,696	18,491	17,845
Net income before income taxes	19,126	15,505	12,233	9,535	7,824
Provision for income taxes	5,134	7,316	4,759	3,717	3,086
Net income	$13,992	$8,189	$7,474	$5,818	$4,738
Total assets	$824,398	$745,427	$657,975	$599,286	$538,862
Total loans	$566,199	$486,634	$461,123	$400,971	$370,390
Allowance for loan losses	$6,958	$6,669	$6,549	$6,078	$5,451
Total deposits	$726,565	$662,657	$582,353	$527,276	$467,891
Total shareholders' equity	$66,932	$55,700	$47,994	$42,496	$36,497
Balance sheet (period average)					
Total assets	$764,326	$695,320	$622,229	$571,990	$531,528
Total loans	$518,626	$471,747	$428,380	$386,070	$353,389
Total deposits	$677,829	$617,211	$549,416	$503,343	$464,067
Total shareholders' equity	$60,080	$53,251	$46,488	$39,844	$33,810
Asset quality ratios					
Nonperforming loans/total loans	0.20 %	0.62 %	0.59 %	1.13 %	1.79 %
Nonperforming assets/total assets	0.28 %	0.59 %	0.53 %	1.06 %	1.90 %
Allowance for loan losses/total loans	1.23 %	1.37 %	1.42 %	1.52 %	1.47 %
Net loan charge-offs	$711	$480	$329	$473	$1,166
Performance ratios					
Return on average assets	1.83 %	1.18 %	1.20 %	1.02 %	0.89 %
Return on average equity	23.3 %	15.4 %	16.1 %	14.6 %	14.0 %
Net interest margin	4.70 %	4.35 %	4.21 %	4.10 %	4.05 %
Loans to deposits	77.9 %	73.4 %	79.2 %	76.0 %	79.2 %
Efficiency ratio	52.0 %	55.5 %	58.9 %	63.5 %	66.7 %
Per share information					
Basic earnings	$2.74	$1.64	$1.54	$1.21	$0.99
Diluted earnings	$2.68	$1.58	$1.47	$1.15	$0.95

Common cash dividends	$0.36	$0.28	$0.10	$0.00	$0.00
Book value per common share	$13.03	$11.00	$9.80	$8.79	$7.61
Common shares outstanding at period end	5,137,476	5,064,972	4,896,875	4,835,432	4,799,139
Capital ratios – Plumas Bank					
Leverage ratio	9.3 %	8.8 %	9.2 %	9.4 %	9.8 %
Tier 1 risk-based capital	11.8 %	12.0 %	12.1 %	12.7 %	13.2 %
Total risk-based capital	13.0 %	13.2 %	13.3 %	14.0 %	14.4 %

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

We are a bank holding company for Plumas Bank, a California state-chartered commercial bank. We derive our income primarily from interest received on real estate related, commercial, automobile and consumer loans and, to a lesser extent, interest on investment securities, fees received in connection with servicing deposit and loan customers and gains from the sale of government guaranteed loans. Our major operating expenses are the interest we pay on deposits and borrowings and general operating expenses. We rely on locally-generated deposits to provide us with funds for making loans.

We are subject to competition from other financial institutions and our operating results, like those of other financial institutions operating in California, are significantly influenced by economic conditions in California, including the strength of the real estate market. In addition, both the fiscal and regulatory policies of the federal and state government and regulatory authorities that govern financial institutions and market interest rates also impact the Bank's financial condition, results of operations and cash flows.

Critical Accounting Policies

Our accounting policies are integral to understanding the financial results reported. Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and internal control procedures that are intended to ensure valuation methods are applied in an environment that is designed and operating effectively and applied consistently from period to period. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Allowance for Loan Losses. The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are collectively evaluated for impairment.

We evaluate our allowance for loan losses quarterly. We believe that the allowance for loan losses is a “critical accounting estimate” because it is based upon management’s assessment of various factors affecting the collectability of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans.

We cannot provide you with any assurance that economic difficulties or other circumstances which would adversely affect our borrowers and their ability to repay outstanding loans will not occur which would be reflected in increased losses in our loan portfolio, which could result in actual losses that exceed reserves previously established.

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The following discussion is designed to provide a better understanding of significant trends related to the Company's financial condition, results of operations, liquidity and capital. It pertains to the Company's financial condition, changes in financial condition and results of operations as of December 31, 2018 and 2017 and for each of the three years in the period ended December 31, 2018. The discussion should be read in conjunction with the Company's audited consolidated financial statements and notes thereto and the other financial information appearing elsewhere herein.

Overview

The Company recorded net income of $14.0 million for the year ended December 31, 2018, an increase of $5.8 million or 71% over net income of $8.2 million during the year ended December 31, 2017. Pretax income increased by $3.6 million, or 23%, to $19.1 million in 2018 from $15.5 million during the year ended December 31, 2017. Net income for 2017 was reduced by $1.4 million, or $0.27 per diluted share, because of a one-time revaluation of the Company's deferred tax assets.

Net interest income increased by $5.2 million to $33.1 million during 2018 from $27.9 million for the year ended December 31, 2017. This increase in net interest income resulted from an increase in interest income of $5.4 million and an increase in interest expense of $219 thousand. Interest on loans increased by $4.0 million, interest on investment securities increased by $1.5 million. Interest on other interest earning assets decreased by $64 thousand. The provision for loan losses was $1.0 million during 2018 up $400 thousand from $600 thousand during 2017.

During the year ended December 31, 2018 non-interest income totaled $8.9 million an increase of $601 thousand from the $8.3 million earned during 2017. Non-interest expense increased by $1.7 million to $21.8 million during the twelve months ended December 31, 2018. The largest component of the increase in non-interest expense was an increase in salary and benefit expense of $633 thousand.

The provision for income taxes decreased by $2.2 million from $7.3 million in 2017 to $5.1 million during the year ended December 31, 2018.

Total assets at December 31, 2018 were $824 million, an increase of $79 million from $745 million at December 31, 2017. This increase included increases of $80.3 million in net loans ($79.6 million in gross loans), $34.0 million in investment securities, $2.9 million in premises and equipment and $2.8 million in other assets. These items were partially offset by a decrease of $40.8 million in cash and due from banks and $0.2 million in OREO.

Gross loans increased by $79.6 million, or 16%, from $486.6 million at December 31, 2017 to $566.2 million at December 31, 2018. The increase in loan balances includes $31.4 million in commercial real estate loans, $16.7 million in automobile loans, $15.0 million in construction and land development loans, $10.3 million in agricultural loans and $9.9 million in commercial loans. These increases were partially offset by declines in other loan categories the largest of which was a decrease of $3.3 million in equity lines of credit.

Total deposits increased by $63.9 million, or 10%, from $662.7 million at December 31, 2017 to $726.6 million at December 31, 2018. The increase in deposits includes $45 million in deposits at our Carson City, Nevada branch which we purchased from Mutual of Omaha Bank on October 26, 2018. At December 31, 2018, 42% of the Company's deposits were in the form of non-interest-bearing demand deposits. At December 31, 2017, 43% of the Company's deposits were in the form of non-interest-bearing demand deposits.

The increase in deposits of $63.9 million includes increases of $22.0 million in money market accounts, $21.8 million in demand deposits, $10.9 million in time deposits, $5.9 million in interest-bearing demand deposits and $3.3 million in savings accounts. The increase in time deposits relates to the Carson City branch acquisition as does much of the increase in money market accounts. The Company has no brokered deposits.

Total shareholders' equity increased by $11.2 million from $55.7 million at December 31, 2017 to $66.9 million at December 31, 2018. The largest component of the $11.2 million increase was earnings during the twelve-month period totaling $14.0 million. During 2018 the Company paid two 18 cents per share semi-annual cash dividends which had the effect of reducing shareholders' equity by $1.8 million.

The return on average assets was 1.83% for 2018, up from 1.18% for 2017. The return on average equity was 23.3% for 2018, up from 15.4% for 2017.

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Results of Operations

Net Interest Income

The following table presents, for the years indicated, the distribution of consolidated average assets, liabilities and shareholders' equity. Average balances are based on average daily balances. It also presents the amounts of interest income from interest-earning assets and the resultant yields expressed in both dollars and yield percentages, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and rate percentages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

	Year ended December 31,											
	2018				**2017**				**2016**			
	Average balance	**Interest income/ expense**	**Rates earned/ paid**		**Average balance**	**Interest income/ expense**	**Rates earned/ paid**		**Average balance**	**Interest income/ expense**	**Rates earned/ paid**	
	(dollars in thousands)											
Assets												
Interest bearing deposits	$32,937	$610	1.85	%	$56,524	$674	1.19	%	$43,843	$274	0.62	%
Investment securities(1)	152,966	3,951	2.58		114,477	2,479	2.17		99,689	1,898	1.90	
Total loans (2)(3)	518,626	29,761	5.74		471,747	25,800	5.47		428,380	22,928	5.35	
Total earning assets	704,529	34,322	4.87	%	642,748	28,953	4.50	%	571,912	25,100	4.39	%
Cash and due from banks	21,639				19,531				17,494			
Other assets	38,158				33,041				32,823			
Total assets	$764,326				$695,320				$622,229			
Liabilities and shareholders’ equity												
Interest bearing demand deposits	$103,494	96	0.09	%	$96,945	89	0.09	%	$92,481	85	0.09	%
Money market deposits	69,405	134	0.19		58,594	84	0.14		54,559	78	0.14	
Savings deposits	176,796	294	0.17		159,707	264	0.17		133,304	217	0.16	
Time deposits	44,715	192	0.43		47,360	145	0.31		50,788	157	0.31	
Note payable	-	-	-		700	28	4.00		3,289	133	4.04	
	10,310	510	4.95		10,310	401	3.89		10,310	348	3.38	

Junior subordinated debentures											
Other	9,132	10	0.11		7,421	6	0.08		6,423	5	0.08	
Total interest-bearing liabilities	413,852	1,236	0.30	%	381,037	1,017	0.27	%	351,154	1,023	0.29	%
Noninterest bearing demand deposits	283,419				254,605				218,284			
Other liabilities	6,975				6,427				6,303			
Shareholders' equity	60,080				53,251				46,488			
Total liabilities and shareholders' equity	$764,326				$695,320				$622,229			
Net interest income		$33,086				$27,936				$24,077		
Net interest spread (4)			4.57	%			4.23	%			4.10	%
Net interest margin (5)			4.70	%			4.35	%			4.21	%

(1) Interest income is reflected on an actual basis and is not computed on a tax-equivalent basis.

(2) Average nonaccrual loan balances of $1.0 million for 2018, $3.2 million for 2017 and $3.8 million for 2016 are included in average loan balances for computational purposes.

(3) Loan origination fees and costs are included in interest income as adjustments of the loan yields over the life of the loan using the interest method. Loan interest income includes net loan costs of $462,000, $501,000 and $678,000 for 2018, 2017 and 2016, respectively.

(4) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(5) Net interest margin is computed by dividing net interest income by total average earning assets.

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The following table sets forth changes in interest income and interest expense, for the years indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

	2018 compared to 2017				**2017 compared to 2016**			
	Increase (decrease) due to change in:				**Increase (decrease) due to change in:**			
	Average Volume(1)	**Average Rate(2)**	**Mix(3)**	**Total**	**Average Volume(1)**	**Average Rate(2)**	**Mix(3)**	**Total**
	(dollars in thousands)							
Interest-earning assets:								
Interest bearing deposits	$(281)	$ 373	$(156)	$(64)	$79	$ 249	$ 72	$400
Investment securities	833	478	161	1,472	282	261	38	581
Loans	2,564	1,271	126	3,961	2,321	500	51	2,872
Total interest income	3,116	2,122	131	5,369	2,682	1,010	161	3,853
Interest-bearing liabilities:								
Interest bearing demand deposits	6	1	-	7	4	-	-	4
Money market deposits	16	29	5	50	6	-	-	6
Savings deposits	28	2	-	30	43	3	1	47
Time deposits	(8)	58	(3)	47	(11)	(1)	-	(12)
Note payable	(28)	-	-	(28)	(105)	(1)	1	(105)
Subordinated debentures	-	-	-	-	-	-	-	-
Junior subordinated debentures	-	109	-	109	-	53	-	53
Other borrowings	1	2	1	4	1	-	-	1
Total interest expense	15	201	3	219	(62)	54	2	(6)
Net interest income	$3,101	$ 1,921	$ 128	$5,150	$2,744	$ 956	$ 159	$3,859

(1) The volume change in net interest income represents the change in average balance multiplied by the previous year’s rate.
(2) The rate change in net interest income represents the change in rate multiplied by the previous year’s average balance.
(3) The mix change in net interest income represents the change in average balance multiplied by the change in rate.

2018 compared to 2017. Net interest income is the difference between interest income and interest expense. Net interest income was $33.1 million for the year ended December 31, 2018, up $5.2 million, or 18%, from $27.9 million during 2017. The $5.2 million included an increase of $5.4 million, or 18.5%, in interest income, from $28.9 million during 2017 to $34.3 million during the current year and an increase of $219 thousand in interest expense.

Interest and fees on loans increased by $4.0 million, interest on investment securities increased by $1.5 million. Interest on deposits decreased by $64 thousand. The increases in interest on loans and investments include both an increase in average balance and an increase in average yield.

Interest and fees on loans was $29.8 million during 2018. The average loan balances were $518.6 million for 2018, up $46.9 million from the $471.7 million during 2017. The following table compares loan balances by type at December 31, 2018 and 2017.

(dollars in thousands)	**Balance at End of Period 12/31/18**	**Percent of Loans in Each Category to Total Loans 12/31/18**		**Balance at End of Period 12/31/17**	**Percent of Loans in Each Category to Total Loans 12/31/17**	
Commercial	$49,563	8.8	%	$39,620	8.1	%
Agricultural	69,160	12.2	%	58,908	12.1	%
Real estate – residential	15,900	2.8	%	16,624	3.4	%
Real estate – commercial	271,710	48.0	%	240,257	49.4	%
Real estate – construction & land development	40,161	7.1	%	25,181	5.2	%
Equity Lines of Credit	38,490	6.8	%	41,798	8.6	%
Auto	77,135	13.6	%	60,438	12.4	%
Other	4,080	0.7	%	3,808	0.8	%
Total Gross Loans	$566,199	100	%	$486,634	100	%

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The average yield on loans was 5.74% for 2018 up 27 basis points from 5.47% for 2017. We attribute much of the increase in yield to an increase in the average prime rate of 81 basis points. At December 31, 2018 approximately 28% of the Company's loan portfolio was comprised of loans tied to the prime rate or an equivalent rate.

Interest on investment securities increased by $1.5 million as a result of an increase in yield of 41 basis points from 2.17% during 2017 to 2.58% during 2018 and an increase in average balance from $114.5 million in 2017 to $153.0 million in 2018. During the current period yield benefited from market conditions and the maturity, sales and payments on lower earning securities. Interest income on interest bearing deposits, which totaled $610 thousand in 2018 and $674 thousand in 2017, primarily relates to interest on cash balances held at the Federal Reserve. The $64 thousand decrease in interest on interest bearing deposits was related to a decrease in average interest earning deposits of $23.6 million from $56.5 million during 2017 to $32.9 million in 2018. The decrease in average balance was mostly offset by an increase in yield of 66 basis points from 119 basis points in 2017 to 185 basis points in 2018; consistent with the increase in the average fed funds rate during these periods.

Interest expense on deposits increased by $134 thousand to $716 thousand for the twelve months ended December 31, 2018, up from $582 thousand in 2017. Of this increase, $81 thousand relates to interest in our Carson City branch which we acquired on October 26, 2018. The average rate paid on the Carson City money market and time deposits exceeds that which the Bank pays in other markets and we would expect some runoff on these accounts as they reprice over time. Interest expense on NOW accounts increased by $7 thousand. Rates paid on NOW accounts averaged 0.09% during 2018 and 2017. Average balances increased by $6.6 million to $103.5 million during 2018 from $96.9 million during 2017. Interest expense on money market accounts increased by $50 thousand to $134 thousand during the year ended December 31, 2018. Rates paid on money market accounts averaged 0.19% during 2018 and 0.14% in 2017. The increase is primarily related to higher cost money market accounts at the Carson City branch. Average balances increased by $10.8 million from $58.6 million in 2017 to $69.4 million during the year ended December 31, 2018. Much of this increase is associated with the acquisition of the Carson City branch. Interest expense on savings accounts increased by $30 thousand as we continued to experience growth in this category of deposits. Average savings deposits increased by $17.1 million from $159.7 million during 2017 to $176.8 million during 2018. The average rate paid on savings accounts was 17 basis points in 2018 and 2017.

Interest expense on time deposits increased $47 thousand from $145 thousand during 2017 to $192 thousand during 2018 primarily as a result of the acquisition of the Carson City branch Average time deposits declined by $2.7 million from $47.4 million during 2017 to $44.7 million during the year ended December 31, 2018. The average rate paid on time deposits was 0.43% in 2018 and 0.31% during 2017.

Interest expense on other interest-bearing liabilities increased by $85 thousand from $435 thousand during the year ended December 31, 2017 to $520 thousand during the current twelve-month period. Interest expense on the Company's note payable decreased by $28 thousand during the twelve months ended December 31, 2018. This decrease was related to a decrease in average borrowings on this note from $700 thousand during 2017 to $0 in 2018. The note payable was paid off in April of 2017. Interest expense on junior subordinated debentures, which increased by $109 thousand to $510 thousand, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

Net interest margin is net interest income expressed as a percentage of average interest-earning assets. As a result of the changes noted above, the net interest margin for 2018 increased to 4.70%, from 4.35% during 2017.

2017 compared to 2016. Net interest income was $27.9 million for the year ended December 31, 2017, up $3.8 million, or 16%, from $24.1 million for 2016. The $3.8 million included an increase of $3.8 million, or 15.4%, in interest income, from $25.1 million during 2016 to $28.9 million during the current year and a decrease of $6 thousand in interest expense.

Interest and fees on loans increased by $2.9 million, interest on investment securities increased by $581 thousand and interest on deposits increased by $400 thousand. These increases include both an increase in average balance and an increase in average yield.

Interest and fees on loans was $25.8 million during 2017. The average loan balances were $471.7 million for 2017, up $43.3 million from the $428.4 million during 2016.

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The average yield on loans was 5.47% for 2017 up 12 basis points from 5.35% for 2016. We attribute much of the increase in yield to an increase in the average prime rate of 59 basis points mostly offset to by price competition in our service area. At December 31, 2017 approximately 30% of the Company's loan portfolio was comprised of loans tied to the prime rate or an equivalent rate.

Interest on investment securities increased by $581 thousand as a result of an increase in yield of 27 basis points from 1.90% during 2016 to 2.17% during 2017 and an increase in average balance from $99.7 million in 2016 to $114.5 million in 2017. During the current period yield benefited from market conditions and the maturity, sales and payments on lower earning securities. Interest income on interest bearing deposits, which totaled $674 thousand in 2017 and $274 thousand in 2016, primarily relates to interest on cash balances held at the Federal Reserve. The $400 thousand increase in interest on interest bearing deposits was related to an increase in yield of 57 basis points from 62 basis points in 2016 to 119 basis points in 2017; consistent with the increase in the average fed funds rate during these periods. In addition, average interest earning deposits increased by $12.7 million from $43.8 million during 2016 to $56.5 million in 2017.

Interest expense on deposits increased by $45 thousand to $582 thousand for the twelve months ended December 31, 2017, up from $537 thousand in 2016. Interest expense on NOW accounts increased by $4 thousand. Rates paid on NOW accounts averaged 0.09% during 2017 and 2016. Average balances increased by $4.4 million to $96.9 million during 2017 from $92.5 million during 2016. Interest expense on money market accounts increased by $6 thousand to $84 thousand during the year ended December 31, 2017. Rates paid on money market accounts averaged 0.14% during 2017 and 2016. Average balances increased by $4.0 million from $54.6 million in 2016 to $58.6 million during the year ended December 31, 2017. Interest expense on savings accounts increased by $47 thousand as we continued to experience strong growth in this category of deposits. Average savings deposits increased by $26.4 million from $133.3 million during 2016 to $159.7 million during 2017. The average rate paid on savings accounts increased slightly from 16 basis points during 2016 to 17 basis points in 2017.

Interest expense on time deposits declined by $12 thousand from $157 thousand during 2016 to $145 thousand during 2017. Average time deposits declined by $3.4 million from $50.8 million during 2016 to $47.4 million during the year ended December 31, 2017. We attribute much of this decline to migration into other types of deposits given the low rates and lack of liquidity associated with time deposits. The average rate paid on time deposits was 0.31% during both 2016 and 2017.

Interest expense on other interest-bearing liabilities decreased by $51 thousand from $486 thousand during the year ended December 31, 2016 to $435 thousand during the current twelve-month period. Interest expense on the Company's note payable decreased by $105 thousand to $28 thousand during the twelve months ended December 31, 2017. This decrease was related to a decrease in average borrowings on this note from $3.3 million during the 2016 to $700 thousand during 2017. The note payable was paid off in April of 2017. Interest expense on junior subordinated debentures, which increased by $53 thousand to $401 thousand, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

As a result of the changes noted above, the net interest margin for 2017 increased to 4.35%, from 4.21% during 2016.

Provision for Loan Losses

During the year ended December 31, 2018 we recorded a provision for loan losses of $1.0 million up $400 thousand from $600 thousand during the year ended December 31, 2017. See “Analysis of Asset Quality and Allowance for Loan Losses” for further discussion of loan quality trends and the provision for loan losses.

The allowance for loan losses is maintained at a level that management believes will be appropriate to absorb inherent losses on existing loans based on an evaluation of the collectability of the loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to repay their loan. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Based on information currently available, management believes that the allowance for loan losses is appropriate to absorb potential risks in the portfolio. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

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Non-Interest Income

The following table sets forth the components of non-interest income for the years ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,			Change during Year	
	2018	2017	2016	2018	2017
	(dollars in thousands)				
Service charges on deposit accounts	$2,576	$2,467	$2,291	$109	$176
Interchange revenue	2,174	1,987	1,740	187	247
Gain on sale of loans, net	1,903	2,039	1,770	(136)	269
Loan servicing fees	800	731	642	69	89
Earnings on bank owned life insurance policies	328	338	341	(10)	(3)
Gain on equity securities with no readily determinable fair value	209	-	-	209	-
Loss on sale of investments	(8)	(158)	(32)	150	(126)
Other income	899	876	900	23	(24)
Total non-interest income	$8,881	$8,280	$7,652	$601	$628

2018 compared to 2017. During the year ended December 31, 2018, non-interest income totaled $8.9 million, an increase of $601 thousand from the twelve months ended December 31, 2017. Included in this increase were two items of a non-recurring nature. A $209 thousand gain was recorded upon the prospective adoption of a newly effective accounting pronouncement impacting the measurement of equity securities, which in our case consists of stock in our correspondent banks, without a readily determinable fair market value, and the loss on sale of investment securities declined by $150 thousand to $8 thousand in 2018. Other significant increases in non-interest income included $109 thousand in service charges on deposit accounts, $187 thousand in interchange income and $69 thousand in loan service fees. We attribute these increases primarily to growth in the bank.

The largest decrease in non-interest income was a $136 thousand decline in gains on sale of loans. The decline in gain on sale relates to a decline in the average premium received on sale. Gains on sale of loans mostly relate to sales of SBA 7(a) loans. Gains on sale of loans decreased from $2.0 million during 2017 to $1.9 million during the twelve months ended December 31, 2018. Proceeds from SBA loan sales totaled $41.7 million during 2018 and $36.6 million during the twelve months ended December 31, 2017. Loans originated for sale totaled $38.9 million during the twelve months ended December 31, 2018 and $31.3 million during 2017. Loan servicing income, which increased by $69 thousand, represents servicing income received on the guaranteed portion of SBA loans sold into the secondary market. At December 31, 2018 we were servicing $122 million in guaranteed portions of loans, an increase of $9 million from $113 million at December 31, 2017.

2017 compared to 2016. During the year ended December 31, 2017, non-interest income totaled $8.3 million, an increase of $628 thousand from the twelve months ended December 31, 2016. The largest components of this increase were increases of $423 thousand in service charge income, $269 thousand gain on sale of loans and $89 thousand in loan servicing income. The increase in service charge income includes significant increases in interchange income on debit card transactions, an increase in overdraft income and an increase in service charges on deposit accounts. Interchange income benefited from an increase in the size of the Bank as well as an increase in marketing efforts directed to this product, while overdraft income and service charges on deposit accounts benefited both from an increase in the size of the Bank as well as an increase in rates charged for various services beginning in October of 2016. Gains on sale of loans increased from $1.8 million during 2016 to $2.0 million during the twelve months ended December 31, 2017. Proceeds from SBA loan sales totaled $36.6 million during 2017 and $30.7 million during the twelve months ended December 31, 2016. Loans originated for sale totaled $31.3 million during the twelve months ended December 31, 2017 and $30.4 million during 2016. Loan servicing income, which increased by $89 thousand, represents servicing income received on the guaranteed portion of SBA loans sold into the secondary market. At December 31, 2017 we were servicing $113 million in guaranteed portions of loans, an increase of $16 million from $97 million at December 31, 2016. The largest decrease in non-interest income was a $126 increase in loss on sale of investment securities from $32 thousand in 2016 to $158 thousand in 2017.

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Non-Interest Expense

The following table sets forth the components of other non-interest expense for the years ended December 31, 2018, 2017 and 2016.

	Years Ended December 31,			Change during Year	
	2018	2017	2016	2018	2017
	(dollars in thousands)				
Salaries and employee benefits	$12,138	$11,505	$10,440	$633	$1,065
Occupancy and equipment	2,962	2,840	2,847	122	(7)
Outside service fees	2,376	2,234	2,105	142	129
Professional fees	925	612	608	313	4
Telephone and data communications	528	561	450	(33)	111
Business development	439	389	344	50	45
Advertising and promotion	433	372	366	61	6
Armored car and courier	329	278	248	51	30
Director compensation, education and retirement	267	336	348	(69)	(12)
Deposit insurance	237	248	285	(11)	(37)
Loan collection costs	216	194	166	22	28
Provision from change in OREO valuation	155	124	37	31	87
Stationery and supplies	118	118	119	-	(1)
OREO expenses	76	73	(34)	3	107
Insurance	53	75	78	(22)	(3)
Postage	51	49	40	2	9
Gain on sale of OREO	(47)	(130)	(60)	83	(70)
Other operating expense	585	233	309	352	(76)
Total non-interest expense	$21,841	$20,111	$18,696	$1,730	$1,415

2018 compared to 2017. Non-interest expense increased by $1.7 million to $21.8 million during the twelve months ended December 31, 2018, up from $20.1 million during 2017. The three largest components of this increase were increases of $633 thousand in salaries and benefits, $313 thousand in professional fees and $352 thousand in Other. The largest components of the increase in salary and benefit expense were increases of $762 thousand in salary expense and $386 thousand in bonus expense. Salary expense increased to $9.5 million related to additions to staff and merit and promotion increases. Total Full Time Equivalent (FTE) employees increased from 142 at December 31, 2017 to 155 at December 31, 2018. This increase includes 4 FTE at our Carson City branch. The additional nine FTE includes additions to staff to support branch and lending activities as well as additional administrative personnel. Bonus expense is mostly a function of pretax income; the increase during the 2018 period is primarily related to the increase in pretax income and expansion in 2018 in the bonus plan to include nonofficer level personnel. These items were partially offset by an increase in the deferral of loan origination costs of $731 thousand to $2.5 million related mostly to an increase in loan origination activity.

Professional fees increased by $313 thousand related primarily to an $139 thousand increase in consulting expense and a $132 thousand increase in legal expense. The increase in consulting costs includes costs related to an external review of our compliance management system and ongoing bank compliance consulting and $30 thousand related to our acquisition of Mutual Omaha Bank's Carson City Nevada branch. The increase in legal expense mostly relates to costs associated with the above-mentioned branch acquisition and costs associated with litigation brought by a third-party municipality against one of our borrowers which could adversely affect our collateral position. The increase in other non-interest expense included a $50 thousand increase in the reserve for undisbursed loan commitments, an increase of $63 thousand in charge offs on over drafted deposit accounts and an accrual for costs associated with the termination of our lease at our Tahoe City, California branch. In 2018 we purchased a building in Tahoe City which, after remodeling is complete, will become the new home of our Tahoe City Branch. Our lease obligation at our current location includes a termination penalty that has been accrued into other expense. These three items accounted for approximately 70% of the $352 thousand increase in Other expense.

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2017 compared to 2016. Non-interest expense increased by $1.4 million to $20.1 million during the twelve months ended December 31, 2017, up from $18.7 million during 2016. The largest components of this increase were $1.1 million in salary and benefit expense, $129 thousand in outside service fees, $111 thousand in telephone and data communication costs and $107 thousand in OREO expenses. The largest declines in non-interest expense were $70 thousand in gain on sale of OREO and $76 thousand in other operating expense.

Salary expense increased by $481 thousand to $8.8 million related to additions to staff and merit and promotion increases. Bonus expense increased by $199 thousand related to increased profitability, commission expense, related to our SBA operations, increased by $121 thousand consistent with an increase in SBA activity, payroll tax expense increased by $81 thousand and health insurance costs increased by $67 thousand. Outside service fees increased by $129 thousand to $2.2 million during the twelve months ended December 31, 2017. This increase included an increase in expenses related to the generation of interchange income consistent with the increase in interchange income and an increase in expense related to the outsourced operations of the Company’s computer network as well as an increase in costs associated with the Company’s online banking offerings.

During 2017 the Company expanded its data communication network, installed a secondary fallback network at its branches and changed data communication providers. The increases in telephone and data communications was primarily related to the expanded data communication network and to a lesser extent to one-time costs related to the conversion to a new data communication provider. OREO costs in 2016 were abnormally low, benefiting from a reimbursement of previously incurred costs and $86 thousand in rental income on a new OREO property which was sold in December of 2016. During the year ended December 31, 2016 we sold 6 OREO properties for total proceeds of $2.2 million recording a net gain on sale of $60 thousand. This compares to proceeds of $0.7 million on the sale of 5 properties and a net gain on sale of $130 thousand during 2017. The $130 thousand gain is related to one property which was acquired and sold during the fourth quarter of 2017.

Provision for Income Taxes. The Company recorded an income tax provision of $5.1 million, or 26.8% of pre-tax income for the year ended December 31, 2018. This compares to an income tax provision of $7.3 million, or 47.2% of pre-tax income during 2017. The decline from 47.2% to 26.8% mostly relates from a change in the Federal corporate tax rate, under the Tax Cuts and Jobs Act, from 34% to 21% and a one-time revaluation of the Company’s deferred tax assets during the fourth quarter of 2017 totaling $1.4 million. The percentages for 2018 and 2017 differ from statutory rates as tax exempt items of income such as earnings on Bank owned life insurance and municipal loan and securities interest decrease taxable income. In addition, the 2018 and 2017 provision include income tax benefits related to the exercise of stock options of $134 thousand and $112 thousand, respectively.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the analysis of available evidence, management has determined that it is "more likely than not" that all deferred income tax assets as of December 31, 2018 and 2017 will be fully realized and therefore no valuation allowance was recorded.

Financial Condition

Loan Portfolio. Gross loans balances increased by $79 million, or 16%, from $487 million at December 31, 2017 to $566 million at December 31, 2018. The increase in loan balances includes increases of $31.4 million in commercial real estate loans, $16.7 million in automobile loans, $15.0 million in construction loans, $10.3 million in agricultural loans and $9.9 million in commercial loans. These increases were partially offset by declines in other loan categories the largest of which was a decrease of $3.3 million in equity lines of credit. While construction loans increased by $15 million they remain a low percentage of the Company’s overall loan portfolio at 7.1% at December 31, 2018. The Company continues to manage the mix of its loan portfolio consistent with its identity as a community bank serving the financing needs of all sectors of the area it serves. Although the Company offers a broad array of financing options, it continues to concentrate its focus on small to medium sized commercial businesses. These loans offer diversification as to industries and types of businesses, thus limiting material exposure in any industry concentrations. The Company offers both fixed and floating rate loans and obtains collateral in the form of real property, business assets and deposit accounts, but looks to business and personal cash flows as its primary source of repayment.

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As shown in the following table the Company's largest lending categories are commercial real estate loans, auto loans, equity lines of credit, agricultural loans and commercial loans.

(dollars in thousands)	Balance at End of Period 12/31/18	Percent of Loans in Each Category to Total Loans 12/31/18		Balance at End of Period 12/31/17	Percent of Loans in Each Category to Total Loans 12/31/17	
Commercial	$49,563	8.8	%	$39,620	8.1	%
Agricultural	69,160	12.2	%	58,908	12.1	%
Real estate – residential	15,900	2.8	%	16,624	3.4	%
Real estate – commercial	271,710	48.0	%	240,257	49.4	%
Real estate – construction & land development	40,161	7.1	%	25,181	5.2	%
Equity Lines of Credit	38,490	6.8	%	41,798	8.6	%
Auto	77,135	13.6	%	60,438	12.4	%
Other	4,080	0.7	%	3,808	0.8	%
Total	$566,199	100	%	$486,634	100	%

The Company’s real estate related loans, including real estate mortgage loans, real estate construction and land development loans, consumer equity lines of credit, and agricultural loans secured by real estate comprised 71% of the total loan portfolio at December 31, 2018. Moreover, the business activities of the Company currently are focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta, and Sierra and in Washoe County in Northern Nevada. Consequently, the results of operations and financial condition of the Company are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of the Company's operations in these areas of Northeastern California and Northwestern Nevada exposes it to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in these regions.

The rates of interest charged on variable rate loans are set at specific increments in relation to the Company's lending rate or other indexes such as the published prime interest rate or U.S. Treasury rates and vary with changes in these indexes. The frequency in which variable rate loans reprice can vary from one day to several years. At December 31, 2018 and December 31, 2017, approximately 75% of the Company's loan portfolio was comprised of variable rate loans. At December 31, 2018 and December 31, 2017, 33% and 40%, respectively of the variable loans were at their respective floor rate. While real estate mortgage, commercial and consumer lending remain the foundation of the Company's historical loan mix, some changes in the mix have occurred due to the changing economic environment and the resulting change in demand for certain loan types. The most significant change has been an increase in indirect auto lending with automobile loans increasing from 2.5% of gross loans at December 31, 2011 to 13.6% of gross loans at December 31, 2018. The automobile portfolio provides diversification to the loan portfolio in terms of rate, term and balance as these loans tend to have a much shorter term and balance than commercial real-estate loans and are fixed rate. In addition, the Company remains committed to the agricultural industry in Northern California and will continue to pursue high quality agricultural loans. Agricultural loans include both commercial and commercial real estate loans. The Company's agricultural loan balances totaled $69 million at December 31, 2018 and $59 million at December 31, 2017.

The following table sets forth the amounts of loans outstanding by category as of the dates indicated.

	At December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
	(dollars in thousands)				
Real estate – mortgage	$287,610	$256,881	$247,419	$217,569	$192,590
Real estate – construction and land development	40,161	25,181	21,904	16,188	24,572
Commercial	49,563	39,620	41,293	37,084	31,465
Consumer (1)	119,705	106,044	99,404	90,274	86,408
Agriculture (2)	69,160	58,908	51,103	39,856	35,355
Total loans	566,199	486,634	461,123	400,971	370,390
Deferred costs	3,257	2,283	2,006	1,940	1,848
Allowance for loan losses	(6,958)	(6,669)	(6,549)	(6,078)	(5,451)
Net loans	$562,498	$482,248	$456,580	$396,833	$366,787

(1) Includes equity lines of credit and auto

(2) Includes agriculture real estate

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The following table sets forth the maturity of gross loan categories as of December 31, 2018. Also provided with respect to such loans are the amounts due after one year, classified according to sensitivity to changes in interest rates:

	Within One Year	**After One Through Five Years**	**After Five Years**	**Total**
	(dollars in thousands)			
Real estate – mortgage	$21,771	$65,720	$200,119	$287,610
Real estate – construction and land development	23,404	10,489	6,268	40,161
Commercial	17,010	18,425	14,128	49,563
Consumer	18,420	58,457	42,828	119,705
Agriculture	25,107	15,721	28,332	69,160
Total	$105,712	$168,812	$291,675	$566,199
Loans maturing after one year with:				
Fixed interest rates		$77,343	$28,775	$106,118
Variable interest rates		91,469	262,900	354,369
Total		$168,812	$291,675	$460,487

Analysis of Asset Quality and Allowance for Loan Losses. The Company attempts to minimize credit risk through its underwriting and credit review policies. The Company's credit review process includes internally prepared credit reviews as well as contracting with an outside firm to conduct periodic credit reviews. The Company's management and lending officers evaluate the loss exposure of classified and impaired loans on a quarterly basis, or more frequently as loan conditions change. The Management Asset Resolution Committee (MARC) reviews the asset quality of criticized and past due loans on a monthly basis and reports the findings to the full Board of Directors. In management's opinion, this loan review system helps facilitate the early identification of potential criticized loans. The Company has implemented MARC to develop an action plan to significantly reduce nonperforming assets. It consists of the Bank's Chief Executive Officer, Chief Financial Officer and Chief Credit Officer, and the activities are governed by a formal written charter. The MARC meets monthly and reports to the Board of Directors.

More specifically, a formal plan to effect repayment and/or disposition of every significant nonperforming loan relationship is developed and documented for review and on-going oversight by the MARC. Some of the strategies used include but are not limited to: 1) obtaining additional collateral, 2) obtaining additional investor cash infusion, 3) sale of the promissory note to an outside party, 4) proceeding with foreclosure on the underlying collateral, and 5) legal action against borrower/guarantors to encourage settlement of debt and/or collect any deficiency balance owed. Each step includes a benchmark timeline to track progress.

MARC also provides guidance for the maintenance and timely disposition of OREO properties; including developing financing and marketing programs to incent individuals to purchase OREO.

The allowance for loan losses is established through charges to earnings in the form of the provision for loan losses. Loan losses are charged to and recoveries are credited to the allowance for loan losses. The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in the loan portfolio. The adequacy of the allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectability of loans; including current economic conditions, maturity of the portfolio, size of the portfolio, industry concentrations, borrower credit history, collateral, the existing allowance for loan losses, independent credit reviews, current charges and recoveries to the allowance for loan losses and the overall quality of the portfolio as determined by management, regulatory agencies, and independent credit review consultants retained by the Company. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The collectability of a loan is subjective to some degree, but must relate to the borrower’s financial condition, cash flow, quality of the borrower’s management expertise, collateral and guarantees, and state of the local economy.

Formula allocations are calculated by applying loss factors to outstanding loans with similar characteristics. Loss factors are based on the Company’s historical loss experience as adjusted for changes in the business cycle and may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Historical loss data from the beginning of the latest business cycle are incorporated in the loss factors.

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The discretionary allocation is based upon management's evaluation of various loan segment conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

The following table provides certain information for the years indicated with respect to the Company's allowance for loan losses as well as charge-off and recovery activity.

	For the Year Ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
	(dollars in thousands)				
Balance at beginning of period	$6,669	$6,549	$6,078	$5,451	$5,517
Charge-offs:					
Commercial and agricultural (2)	325	202	268	91	191
Real estate mortgage	25	48	292	132	1,015
Real estate construction & land	-	-	5	55	106
Consumer (1)	841	629	414	549	601
Total charge-offs	1,191	879	979	827	1,913
Recoveries:					
Commercial and agricultural (2)	83	89	53	173	89
Real estate mortgage	114	118	45	8	19
Real estate construction & land	3	-	389	-	491
Consumer (1)	280	192	163	173	148
Total recoveries	480	399	650	354	747
Net charge-offs	711	480	329	473	1,166
Provision for loan losses	1,000	600	800	1,100	1,100
Balance at end of period	$6,958	$6,669	$6,549	$6,078	$5,451
Net charge-offs during the period to average loans	0.14 %	0.10 %	0.08 %	0.12 %	0.33 %
Allowance for loan losses to total loans	1.23 %	1.37 %	1.42 %	1.52 %	1.47 %

(1) Includes equity lines of credit and auto

(2) Includes agriculture real estate

During the years ended December 31, 2018 and 2017 we recorded a provision for loan losses of $1 million and $600 thousand, respectively. Net charge-offs totaled $711 thousand during the year ended December 31, 2018 up $231 thousand from $480 thousand during the year ended December 31, 2017. This increase was mostly related to an increase in charge-offs on automobile loans. Net charge-offs as a percentage of average loans increased from 0.10% during 2017 to 0.14% during the year ended December 31, 2018.

The following table provides a breakdown of the allowance for loan losses:

(dollars in thousands)	Balance at End of Period 2018	Percent of Loans in Each Category to Total Loans 2018		Balance at End of Period 2017	Percent of Loans in Each Category to Total Loans 2017	
Commercial and agricultural	$ 1,452	21.0	%	$ 1,348	20.2	%
Real estate mortgage	2,900	50.8	%	2,960	52.8	%
Real estate construction & land	758	7.1	%	783	5.2	%
Consumer (includes equity lines of credit & auto)	1,848	21.1	%	1,578	21.8	%
Total	$ 6,958	100.0	%	$ 6,669	100.0	%

The allowance for loan losses totaled $7.0 million at December 31, 2018 and $6.7 million at December 31, 2017. Specific reserves related to impaired loans increased by $99 thousand from $82 thousand at December 31, 2017 to $181 thousand at December 31, 2018. At least quarterly the Company evaluates each specific reserve and if it determines that the loss represented by the specific reserve is uncollectable it records a charge-off for the uncollectable portion. General reserves were $6.8 million at December 31, 2018 and $6.6 million at December 31, 2017. The allowance for loan losses as a percentage of total loans decreased from 1.37% at December 31, 2017 to 1.23% at December 31, 2018. The percentage of general reserves to unimpaired loans totaled 1.20% at December 31, 2018 and 1.36% at December 31, 2017.

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The Company places loans 90 days or more past due on nonaccrual status unless the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 90 days. Included in nonperforming loans at December 31, 2017 were three loans to one customer totaling $1.8 million that were 90 days past due and still accruing interest. These loans were well secured and in process of collection at December 31, 2017. During 2018 we collected all principal and interest due on these loans. When a loan is placed on nonaccrual status the Company's general policy is to reverse and charge against current income previously accrued but unpaid interest. Interest income on such loans is subsequently recognized only to the extent that cash is received, and future collection of principal is deemed by management to be probable. Where the collectability of the principal or interest on a loan is considered to be doubtful by management, it is placed on nonaccrual status prior to becoming 90 days delinquent.

Impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary difference between impaired loans and nonperforming loans is that impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include identified problem loans other than delinquent loans where it is considered probable that we will not collect all amounts due to us (including both principal and interest) in accordance with the contractual terms of the loan agreement.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

Loans restructured (TDRs) and not included in nonperforming loans in the following table totaled $1.0 million, $1.1 million, $2.6 million, $2.0 million and $2.0 million at December 31, 2018, 2017, 2016, 2015 and 2014, respectively. For additional information related to restructured loans see Note 5 of the Company’s Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

The following table sets forth the amount of the Company's nonperforming assets as of the dates indicated.

	At December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
	(dollars in thousands)				
Nonaccrual loans	$1,117	$1,226	$2,724	$4,546	$6,625

Loans past due 90 days or more and still accruing	-	1,796	-	-	-
Total nonperforming loans	1,117	3,022	2,724	4,546	6,625
Other real estate owned	1,170	1,344	735	1,756	3,590
Other vehicles owned	53	35	12	30	13
Total nonperforming assets	$2,340	$4,401	$3,471	$6,332	$10,228
Interest income forgone on nonaccrual loans	$46	$50	$164	$303	$345
Interest income recorded on a cash basis on nonaccrual loans	$-	$-	$29	$-	$31
Nonperforming loans to total loans	0.20 %	0.62 %	0.59 %	1.13 %	1.79 %
Nonperforming assets to total assets	0.28 %	0.59 %	0.53 %	1.06 %	1.90 %

Nonperforming loans at December 31, 2018 were 1.1 million, a decrease of $1.9 million from the $3.0 million balance at December 31, 2017. Specific reserves on nonaccrual loans totaled $128 thousand at December 31, 2018 and $24 thousand at December 31, 2017, respectively. Performing loans past due thirty to eighty-nine days were $2.6 million at December 31, 2018 and $3.4 million at December 31, 2017.

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A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Total substandard loans decreased by $2.4 million from $3.2 million at December 31, 2017 to $741 thousand at December 31, 2018. Loans classified as special mention increased by $3.6 million from $642 thousand at December 31, 2017 to $4.3 million at December 31, 2018. At December 31, 2018, $33 thousand of performing loans were classified as substandard. Further deterioration in the credit quality of individual performing substandard loans or other adverse circumstances could result in the need to place these loans on nonperforming status.

At December 31, 2018 and December 31, 2017, the Company's recorded investment in impaired loans totaled $1.3 million and $2.3 million, respectively. The specific allowance for loan losses related to impaired loans totaled $181 thousand and $82 thousand at December 31, 2018 and December 31, 2017, respectively. Additionally, $11 thousand had been charged off against the impaired loans at December 31, 2018 and December 31, 2017.

It is the policy of management to make additions to the allowance for loan losses so that it remains appropriate to absorb the inherent risk of loss in the portfolio. Management believes that the allowance at December 31, 2018 is appropriate. However, the determination of the amount of the allowance is judgmental and subject to economic conditions which cannot be predicted with certainty. Accordingly, the Company cannot predict whether charge-offs of loans in excess of the allowance may occur in future periods.

OREO represents real property acquired by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Repossessed assets include vehicles and other commercial assets acquired under agreements with delinquent borrowers. OREO holdings represented six properties totaling $1.2 million at December 31, 2018 and six properties totaling $1.3 million at December 31, 2017. Nonperforming assets as a percentage of total assets were 0.28% at December 31, 2018 and 0.59% at December 31, 2017.

The following table provides a summary of the change in the number and balance of OREO properties for the years ended December 31, 2018 and 2017, dollars in thousands:

	Year Ended December 31,			
	#	**2018**	**#**	**2017**
Beginning Balance	6	$1,344	6	$735
Additions	4	656	5	1,292
Dispositions	(4)	(675)	(5)	(559)
Provision from change in OREO valuation	-	(155)	-	(124)
Ending Balance	6	$1,170	6	$1,344

Investment Portfolio and Federal Reserve Balances. Total investment securities were $171.5 million as of December 31, 2018 and $137.5 million as of December 31, 2017. Unrealized loss on available-for-sale investment securities totaling $2.9 million were recorded, net of $846 thousand in tax benefits, as accumulated other comprehensive income within shareholders' equity at December 31, 2018. During the year ended December 31, 2018 the Company sold eighteen available-for-sale investment securities for total proceeds of $4,157,000 recording a $8,000 loss on sale. The Company realized a gain on sale from eight of these securities totaling $4,000 and a loss on sale on ten securities of $12,000. The investment portfolio at December 31, 2018 consisted of $132.7 million in securities of U.S. Government-sponsored agencies and 119 municipal securities totaling $38.8 million. Unrealized loss on available-for-sale investment securities totaling $809 thousand were recorded, net of $239 thousand in tax benefits, as accumulated other comprehensive income within shareholders' equity at December 31, 2017. During the year ended December 31, 2017 the Company sold sixteen available-for-sale investment securities for total proceeds of $9.6 million recording a $158 thousand loss on sale. The Company realized a gain on sale from four of these securities totaling $4 thousand and a loss on sale on twelve securities of $162 thousand. The investment portfolio at December 31, 2017 consisted of $103.8 million in securities of U.S. Government-sponsored agencies and 115 municipal securities totaling $33.7 million.

The Bank maintained interest earning balances at the Federal Reserve Bank totaling $19.9 million at December 31, 2018 and $62.2 million at December 31, 2017. The balances, at December 31, 2018, earn interest at the rate of 2.40%.

The Company classifies its investment securities as available-for-sale or held-to-maturity. Currently all securities are classified as available-for-sale. Securities classified as available-for-sale may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors.

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The following tables summarize the values of the Company's investment securities held on the dates indicated:

Available-for-sale (fair value)	December 31, 2018	2017	2016
	(dollars in thousands)		
U.S. Government-sponsored agency residential mortgage-backed securities	$132,678	$103,788	$74,911
Municipal obligations	38,829	33,678	26,684
Total	$171,507	$137,466	$101,595

The following table summarizes the maturities of the Company's securities at their carrying value, which represents fair value, and their weighted average tax equivalent yields at December 31, 2018. Mortgage-backed securities are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because the issuers may have the right to call or prepay obligations.

(dollars in thousands)	Within One Year		After One Through Five Years		After Five Through Ten Years		After Ten Years		Total	
Available-for-sale (Fair Value)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Government-sponsored agency residential mortgage-backed securities	$ -	- %	$-	- %	$20,883	2.09 %	$111,795	2.79 %	$132,678	2.68 %
Municipal obligations	-	- %	3,636	2.59 %	16,525	2.76 %	18,668	3.65 %	38,829	3.18 %
Total	$ -	- %	$3,636	2.59 %	$37,408	2.39 %	$130,463	2.91 %	$171,507	2.79 %

Deposits. Total deposits increased by $63.9 million, or 10%, from $662.7 million at December 31, 2017 to $726.6 million at December 31, 2018. The increase in deposits includes $45 million in deposits at our Carson City, Nevada branch which we purchased from Mutual of Omaha Bank on October 26, 2018. At December 31, 2018, 42% of the Company’s deposits were in the form of non-interest-bearing demand deposits. At December 31, 2017, 43% of the Company’s deposits were in the form of non-interest-bearing demand deposits. The increase in deposits of $63.9 million includes increases of $22.0 million in money market accounts, $21.8 million in demand deposits, $10.9 million in time deposits, $5.9 million in interest-bearing demand deposits and $3.3 million in savings accounts. The increase in time deposits relates to the Carson City branch acquisition as does much of the increase in money market accounts. The Company has no brokered deposits. The Company continues to manage the mix of its deposits consistent with its identity as a community bank serving the financial needs of its customers.

The following table shows the distribution of deposits by type at December 31, 2018 and 2017.

(dollars in thousands)	Balance at End of Period 12/31/18	Percent of Deposits in Each Category to Total Deposits 12/31/18		Balance at End of Period 12/31/17	Percent of Deposits in Each Category to Total Deposits 12/31/17	
Non-interest bearing	$304,039	41.8	%	$282,239	42.6	%
NOW	105,107	14.5	%	99,195	15.0	%
Money Market	82,743	11.4	%	60,757	9.2	%
Savings	177,710	24.5	%	174,426	26.3	%
Time	56,966	7.8	%	46,040	6.9	%
Total Deposits	$726,565	100	%	$662,657	100	%

Deposits represent the Bank's primary source of funds. Deposits are primarily core deposits in that they are demand, savings and time deposits generated from local businesses and individuals. These sources are considered to be relatively stable, long-term relationships thereby enhancing steady growth of the deposit base without major fluctuations in overall deposit balances. The Company experiences, to a small degree, some seasonality with the slower growth period between November through April, and the higher growth period from May through October. To assist in meeting any funding demands, the Company maintains a secured borrowing arrangement with the FHLB. There were no brokered deposits at December 31, 2018 or December 31, 2017.

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The Company's time deposits of $100,000 or more had the following schedule of maturities at December 31, 2018 (dollars in thousands):

Remaining Maturity:	**Amount**
Three months or less	$ 5,094
Over three months to six months	5,793
Over six months to 12 months	9,708
Over 12 months	4,247
Total	$ 24,842

Time deposits of $100,000 or more are generally from the Company's local business and individual customer base. The potential impact on the Company's liquidity from the withdrawal of these deposits is discussed at the Company's asset and liability management committee meetings, and is considered to be minimal.

Short-term Borrowing Arrangements. The Company is a member of the FHLB and can borrow up to $207 million from the FHLB secured by commercial and residential mortgage loans with carrying values totaling $340 million. The Company is required to hold FHLB stock as a condition of membership. At December 31, 2018 and December 31, 2017, the Company held $3.0 million and $2.7 million, respectively of FHLB stock which is recorded as a component of other assets. Based on this level of stock holdings at December 31, 2018, the Company can borrow up to $112.1 million. To borrow the $207 million in available credit the Company would need to purchase $2.6 million in additional FHLB stock. In addition to its FHLB borrowing line, the Company has unsecured short-term borrowing agreements with three of its correspondent banks in the amounts of $20 million, $11 million and $10 million. There were no outstanding borrowings to the FHLB or the correspondent banks under these agreements at December 31, 2018 and 2017.

Note Payable and Term Loan. On October 1, 2015, the Company entered into a $5.0 million term loan (the "Term Loan"), which was scheduled to mature on October 1, 2018. On April 20, 2017 Plumas Bancorp paid off the $2,250,000 remaining balance on the Term Loan. The payment was funded through a $4 million dividend from Plumas Bank.

On October 1, 2018 the Company renewed its line of credit, for a one-year term, with the same lender (the "Note"). The maximum amount outstanding at any one time on the Note cannot exceed $5 million. There were no borrowings on the Note during 2018 or 2017. The Note bears interest at a rate of the U.S. "Prime Rate" plus one-quarter percent per annum and is secured by 100 shares of Plumas Bank stock representing the Company's 100% ownership interest in Plumas Bank. Under the Note, the Bank is subject to several negative and affirmative covenants including, but not limited to providing timely financial information, maintaining specified levels of capital, restrictions on additional borrowings, and meeting or exceeding certain capital and asset quality ratios. The Bank was in compliance with all such covenants related to the Note at December 31, 2018 and December 31, 2017. Interest expense related to the Term Loan for the years ended December 31, 2018, 2017 and 2016 totaled $0, $28 thousand and $133 thousand, respectively.

Repurchase Agreements. In 2011 the Bank introduced a new product for its larger business customers which use securities sold under agreements to repurchase as an alternative to interest-bearing deposits. Securities sold under agreements to repurchase totaling $13.1 million at December 31, 2018 and $10.1 million at December 31, 2017 are secured by U.S. Government agency securities with a carrying amount of $21.8 million and $16.8 million at December 31, 2018 and 2017, respectively. Interest paid on this product is similar to that which is paid on the Bank's premium money market account; however, these are not deposits and are not FDIC insured.

Junior Subordinated Deferrable Interest Debentures. Plumas Statutory Trust I and II are business trust subsidiaries formed by the Company with capital of $338 thousand and $174 thousand, respectively, for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company.

During 2002, Trust I issued 6,000 Floating Rate Capital Trust Pass-Through Securities ("Trust Preferred Securities"), with a liquidation value of $1,000 per security, for gross proceeds of $6,000,000. During 2005, Trust II issued 4,000 Trust Preferred Securities with a liquidation value of $1,000 per security, for gross proceeds of $4,000,000. The entire proceeds were invested by Trust I in the amount of $6,186,000 and Trust II in the amount of $4,124,000 in Floating Rate Junior Subordinated Deferrable Interest Debentures (the "Subordinated Debentures") issued by the Company, with identical maturity, repricing and payment terms as the Trust Preferred Securities. The Subordinated Debentures represent the sole assets of Trusts I and II.

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Trust I’s Subordinated Debentures mature on September 26, 2032, bear a current interest rate of 6.22% (based on 3-month LIBOR plus 3.40%), with repricing and payments due quarterly. Trust II’s Subordinated Debentures mature on September 28, 2035, bear a current interest rate of 4.27% (based on 3-month LIBOR plus 1.48%), with repricing and payments due quarterly. The interest rate of the Trust Preferred Securities issued by Trust I adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 3.40%. The Trust Preferred Securities issued by Trust II adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 1.48%. Both Trusts I and II have the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures.

Interest expense recognized by the Company for the years ended December 31, 2018, 2017 and 2016 related to the subordinated debentures was $510,000, $401,000 and $348,000, respectively.

Capital Resources

Total shareholders’ equity increased by $11.2 million from $55.7 million at December 31, 2017 to $66.9 million at December 31, 2018. The $11.2 million includes earnings during the twelve-month period totaling $14.0 million and stock option activity totaling $0.5 million. These items were partially offset by the payment of two $0.18 semi-annual cash dividends totaling $1.8 million and an increase in the unrealized loss on investment securities totaling $1.5 million.

It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends. The Board of Directors believes that such dividends help promote shareholder value and capital adequacy by enhancing the marketability of the Company’s stock. All authority to provide a return to the shareholders in the form of a cash or stock dividend or split rests with the Board of Directors. The Board periodically, but on no regular schedule, reviews the appropriateness of a cash dividend payment. The Company’s ability to pay dividends is limited by California and federal law and the policies and regulations of the FRB as well as restrictions the Subordinated Debentures.

On October 20, 2016 the Company announced that its Board of Directors approved the reinstatement of a semi-annual cash dividend. The dividend in the amount of $0.10 per share was paid on November 21, 2016. On May 15, 2017 and November 15, 2017, the Company paid semi-annual cash dividends each of which totaled $0.14 per share. On May 15, 2018 and November 15, 2018, the Company paid semi-annual cash dividends each of which totaled $0.18 per share.

Warrant. On April 15, 2013 the Company issued a $7.5 million subordinated debenture (“subordinated debt”). The subordinated debt was issued to an unrelated third-party pursuant to a subordinated debenture purchase agreement, subordinated debenture note, and stock purchase warrant. On April 16, 2015 the Company paid off the subordinated debt. The subordinated debt had an interest rate of 7.5% per annum and a term of 8 years with no prepayment allowed during the first two years and was made in conjunction with an eight-year warrant to purchase up to 300,000 shares of the Bancorp's common stock, no par value at an exercise price, subject to anti-dilution adjustments, of $5.25 per share. In May of 2016 the Company repurchased a portion of the warrant, representing the right to purchase 150,000 shares of the registrant's common stock at a cost of $862 thousand. The remaining warrant represented the right to purchase 150,000 shares of Plumas Bancorp common stock at an exercise price of $5.25 per share was scheduled to expire on April 15, 2021. In May 2017 the warrant was exercised in a cashless exercise resulting in the issuance of 108,112 common shares.

Capital Standards. The Company uses a variety of measures to evaluate its capital adequacy. Management reviews these capital measurements on a monthly basis and takes appropriate action to ensure that they are within established internal and external guidelines. The FDIC has promulgated risk-based capital guidelines for all state non-member banks such as the Bank. These guidelines establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures.

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks, sometimes called "Basel III". The phase-in period for the final rules began in 2015, with certain of the rules' requirements phased in over a multi-year schedule. Under the final rules minimum requirements increased for both the quantity and quality of capital held by the Company and the Bank. The new capital rules include a new minimum "common equity Tier 1" ratio of 4.5%, a Tier 1 capital ratio of 6.0% (increased from 4.0%), a total risk-based capital ratio of 8.0%, and a minimum leverage ratio of 4.0% (calculated as Tier 1 capital to average consolidated assets). The effective date of these requirements was January 1, 2015. In addition, the new capital rules include a capital conservation buffer of 2.5% above each of these levels (to be phased in over three years which beginning at 0.625% on January 1, 2016 and increasing by that amount on each subsequent January 1, until reaching 2.5% on January 1, 2019) will be required for banking institutions to avoid restrictions on their ability to pay dividends, repurchase stock or pay discretionary bonuses. Including the capital conservation buffer of 2.5%, the new capital rules would result in the following minimum ratios to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7.0%, and (iii) a total capital ratio of 10.5%. The final rules also implement strict eligibility criteria for regulatory capital instruments.

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Plumas Bancorp qualifies for treatment under the Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the “Policy Statement”) and is thereby not subject to consolidated capital rules at the bank holding company level. On May 24, 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Relief Act”) was signed into law. The Relief Act included a provision to increase the threshold for qualifying for the Policy Statement from $1 billion to $3 billion in total assets.

The new capital rules continue to apply to the Bank. Consistent with the Relief Act, however, the federal banking agencies have proposed a new community bank leverage ratio that is intended to simply the regulatory capital requirements for qualifying community banking organizations. Under the proposal, a qualifying banking organization that so elects would be deemed to have met the well-capital capitalized ratio requirements under the prompt corrective action framework and would be exempt from the generally applicable new capital rules if it maintains a new “community bank leverage ratio” in excess of 9%. The proposed community bank leverage ratio would be equal to tangible equity (as defined the proposal) divided by average total consolidated assets. To qualify, a banking organization would have to have less than $10 billion in assets and limited off balance sheet exposures and other assets. We cannot predict whether or when this proposal will be adopted.

The following table sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

			Minimum Amount of Capital Required			
	Actual		**For Capital Adequacy Purposes (1)**		**To be Well-Capitalized Under Prompt Corrective Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
December 31, 2018						
Common Equity Tier 1 Ratio	$76,545	11.8 %	$29,071	4.5 %	$ 41,911	6.5 %
Tier 1 Leverage Ratio	76,545	9.3 %	32,765	4.0		